Illustration 1: Mr. X has a total income of Rs.12,00,000 comprising of his salary income and interest on fixed deposit. Compute his tax liability.

Solution

Computation of Tax liability

Tax liability = Rs.1,12,500 + 30% of Rs.2,00,000 = Rs.1,72,500 plus education cess @2% and secondary & higher education cess @1% = Rs.1,77,675

Alternatively:

Tax liability :

First Rs.2,50,000	- Nil	
Next Rs.2,50,000 – Rs.5,00,000	- @ 5% of Rs.2,50,000	= Rs.12,500
Next Rs.5,00,000 – Rs.10,00,000	- @ 20% of Rs.5,00,000	=
Rs.1,00,000 Balance i.e. Rs.12,00,000 – Rs.10,00,000		- @ 30% of
Rs.2,00,000	=	Rs.60,000
		Rs.1,72,500
Add: Education cess @2% and Secondary & Higher Education cess @1%=		Rs.5,175
		= Rs.1,77,675

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 Rs.3,00,000. 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 Rs.5,00,000.

Illustration 2

Compute the tax liability of Mr. A (aged 42), having total income of Rs.51 lakhs for the Assessment Year 2018-19. Assume that his total income comprises of "Salary income", "Income under the head house property" and "Interest from Saving Bank Account".

Solution

Computation of tax liability of Mr. A for the A.Y. 2018-19

(A)	Tax payable including surcharge on total income of Rs.51,00,000	
	Rs.2,50,000 – Rs.5,00,000 @ 5%	Rs.12,500
	Rs.5,00,000 – Rs.10,00,000 @ 20%	Rs.1,00,000
	Rs.10,00,000 – Rs.51,00,000 @30%	Rs.12,30,000

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	Total	Rs.13,42,500	
	Add: Surcharge @ 10%	Rs.1,34,250	Rs.14,76,750
(B)	Tax Payable on total income of Rs. 50 lakhs (Rs.12,500 plus Rs.1,00,000 plus Rs.12,00,000)		Rs.13,12,500
(C)	Excess tax payable (A)-(B)		Rs.1,64,250
(D)	Marginal Relief (Rs.1,64,250 – Rs.1,00,000, being the amount of income in excess of Rs.50,00,000)		Rs.64,250
	Tax payable (A)-(D)		Rs.14,12,500
	Add: Education Cess @1% and Secondary & Higher Education Cess @2%		42,375
	Tax Liability		**Rs.14,54,875**
	Tax Liability (Rounded off)		**Rs.14,54,880**

(a) Where the total income > Rs.1 crore

Where the total income exceeds Rs. 1 crore, surcharge is payable at the rate of ***15%*** of income-tax computed in accordance with the provisions of sub-para (1) of para 5.1 above or section 111A or section 112.

Marginal relief

Marginal relief is available in case of such persons having a total income exceeding Rs.1 crore i.e., the total amount of income-tax payable (together with surcharge) should not exceed the amount of income-tax and surcharge payable on total income of Rs.1 crore by more than the amount of income that exceeds Rs.1 crore.

Illustration 3

Compute the tax liability of Mr. A (aged 42), having total income of Rs.1,01,00,000 for the Assessment Year 2018-19. Assume that his total income comprises of "Salary income", "Income under the head house property" and "Interest from fixed deposit Account".

Solution Computation of tax liability of Mr. A for the A.Y. 2018-19

(A)	Tax payable including surcharge on total income of Rs.1,01,00,000		
	Rs.2,50,000 – Rs.5,00,000 @ 5%	Rs.12,500	
	Rs.5,00,000 – Rs.10,00,000 @ 20%	Rs.1,00,000	
	Rs.10,00,000 – Rs.1,01,00,000 @30%	Rs.27,30,000	
	Total	Rs.28,42,500	
	Add: Surcharge @15%	Rs.4,26,375	Rs.32,68,875
(B)	Tax Payable on total income of Rs.1 crore		

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	(Rs.12,500 plus Rs.1,00,000 plus Rs.27,00,000) plus surcharge @10%	Rs.30,93,750
(C)	Excess tax payable (A)-(B)	Rs.1,75,125
(D)	Marginal Relief (Rs.1,75,1258 – Rs.1,00,000, being the amount of income in excess of Rs. 1,00,00,000)	Rs.75,125
	Tax payable (A)-(D)	Rs.31,93,750
	Add: Education Cess @1% and Secondary & Higher Education Cess @2%	95,813
	Tax Liability	**Rs.32,89,563**
	Tax Liability (Rounded off)	**Rs.32,89,560**

Illustration 4

Compute the marginal relief available to X Ltd., a domestic company, assuming that the total come of X Ltd. is Rs.1,01,00,000 for A.Y.2018-19 and the total income does not include any income in the nature of capital gains.[Note - The gross receipts of X Ltd. for the P.Y.2015-16 is Rs.72,00,00,000]

Solution

The tax payable on total income of Rs.1,01,00,000 of X Ltd. computed @32.1% (including surcharge @7%) is Rs.32,42,100. However, the tax cannot exceed Rs.31,00,000 (i.e., the tax of Rs.30,00,000 payable on total income of Rs.1 crore plus Rs. 1,00,000, being the amount of total income exceeding Rs.1 crore). Therefore, the tax payable on Rs. 1,01,00,000 would be Rs. 31,00,000. The marginal relief is Rs. 1,42,100 (i.e., Rs.32,42,100 - Rs.31,00,000).

Illustration 5

Compute the marginal relief available to Y Ltd., a domestic company, assuming that the total income of Y Ltd. for A.Y.2018-19 is Rs.10,01,00,000 and the total income does not include any income in the nature of capital gains.

[Note - The gross receipts of Y Ltd. for the P.Y.2015-16 is Rs.92,00,00,000]

Solution

The tax payable on total income of Rs.10,01,00,000 of Y Ltd. computed@ 33.6% (including surcharge@12%) is Rs.3,36,33,600. However, the tax cannot exceed Rs.3,22,00,000 [i.e., the tax of Rs.3,21,00,000 (32.1% of Rs.10 crore) payable on total income

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of Rs.10 crore plus Rs.1,00,000, being the amount of total income exceeding Rs.10 crore].

Therefore, the tax payable on Rs.10,01,00,000 would be Rs. 3,22,00,000. The marginal relief is Rs.14,33,600 (i.e., Rs.3,36,33,600 - Rs.3,22,00,000).

Illustration 6

Mr. Raghav aged 26 years, has a total income of Rs.3,40,000, comprising his salary income and interest on bank fixed deposit. Compute his tax liability for A.Y.2018-19.

Solution

Computation of tax liability of Mr. Raghav for A.Y.2018-19

Tax on total income of Rs.3,40,000	
@5% of Rs.90,000 (Rs.3,40,000 – Rs.2,50,000)	Rs.4,500
Less: Rebate u/s 87A	Rs.2,500
	Rs.2,000
Add: Education cess@2% and higher education cess@1%	Rs.60
Total tax liability	**Rs.2,060**

EXERCISE

Question 1

Mr. Bhargava, a leading advocate on corporate law, 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 case, he agreed to appear to defend one company in the Supreme Court on the condition that he would be provided with Rs.5 lacs for a public charitable trust that he would create. He defended the company and was paid the sum by the company. He created a trust of that sum by executing a trust deed. Decide whether the amount received by Mr. Bhargava is assessable in his hands as income from profession.

Answer

In the instant case, the trust was created by Mr. Bhargava himself out of his professional income. The client did not create the trust. The client did not impose any obligation in the nature of a trust binding on Mr. Bhargava. Thus, there is no diversion of the money to the trust before it became professional income in the hands of Mr. Bhargava. This case is one of application of professional income and not of diversion of income by overriding title. Therefore, the amount received by Mr. Bhargava is chargeable to tax under the head "Profits and gains of business or profession".

Question 2

XYZ Ltd. took over the running business of a sole-proprietor by a sale deed. As per the sale deed, XYZ

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Ltd. undertook to pay overriding charges of Rs.15,000 p.a. to the wife of the sole-proprietor in addition to the sale consideration. The sale deed also specifically mentioned that the amount was charged on the net profits of XYZ Ltd., who had accepted that obligation as a condition of purchase of the going concern. Is the payment of overriding charges by XYZ Ltd. to the wife of the sole-proprietor in the nature of diversion of income or application of income? Discuss.

Answer

This issue came up for consideration before the Allahabad High Court in Jit & Pal X-Rays (P.) Ltd. v. CIT (2004) 267 ITR 370 (All). The Allahabad High Court observed that the overriding charge which had been created in favour of the wife of the sole-proprietor was an integral part of the sale deed by which the going concern was transferred to the assessee. The obligation, therefore, was attached to the very source of income i.e. the going concern transferred to the assessee by the sale deed. The sale deed also specifically mentioned that the amount in question was charged on the net profits of the assessee-company and the assessee-company had accepted that obligation as a condition of purchase of the going concern. Hence, it is clearly a case of diversion of income by an overriding charge and not a mere application of income.

Question 3

MKG Agency is a partnership firm consisting of father and three major sons. The partnership deed provided that after the death of father, the business shall be continued by the sons, subject to thecondition that the firm shall pay 20% of the profits to the mother. Father died in March, 2017. In the previous year 2017-18, the reconstituted firm paid Rs.1 lakh (equivalent to 20% of the profits) to the mother and claimed the amount as deduction from its income. Examine the correctness of the claim of the firm.

Answer

The issue raised in the problem is based on the concept of diversion of income by overriding title, which is well recognised in the income-tax law. In the instant case, the amount of Rs.1 lakh, being 20% of profits of the firm, paid to the mother gets diverted at source by the charge created in her favour as per the terms of the partnership deed. Such income does not reach the assessee-firm. Rather, such income stands diverted to the other person as such other person has a better title on such income than the title of the assessee. The firm might have received the said amount but it so received for and on behalf of the mother, who possesses the overriding title. Therefore, the amount paid to the mother should be excluded from the income of the firm. This view has been confirmed in CIT vs. Nariman B. Bharucha & Sons (1981) 130 ITR 863 (Bom).

Question 4

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Anand was the Karta of HUF. He died leaving behind his major son Prem, his widow, his grandmother and brother's wife. Can the HUF retain its status as such or the surviving persons would become co-owners?

Answer

In the case of Gowli Buddanna v. CIT (1966) 60 ITR 293 (SC), the Supreme Court has made it clear that there need not be more than one male member to form a HUF as a taxable entity under the Income-tax Act, 1961. The expression "Hindu Undivided family" in the Act is used in the sense in which it is understood under the personal law of the Hindus.

Under the Hindu system of law, a joint family may consist of a single male member and the widows of the deceased male members and the Income-tax Act, 1961 does not mandate that it should consist of at least two male members. Therefore, property of a joint Hindu family does not cease to belong to the family merely because the family is represented by a single co-parcener who possesses the right which an owner of property may posses. Therefore, the HUF would retain its status as such.

Question 5

Mr. C borrowed on Hundi, a sum of Rs.25,000 by way of bearer cheque on 11-09-2017 and repaid the same with interest amounting to Rs.30,000 by account payee cheque on 12-10-2017.

The Assessing Officer (AO) wants to treat the amount borrowed as income during the previous year. Is the action of AO valid?

Answer

Section 69D provides that where any amount is borrowed on a hundi or any amount due thereon is repaid otherwise than by way of an account-payee cheque drawn on a bank, the amount so borrowed or repaid shall be deemed to be the income of the person borrowing or repaying the amount for the previous year in which the amount was so borrowed or repaid, as the case may be.

In this case, Mr. C has borrowed Rs.25,000 on Hundi by way of bearer cheque. Therefore, it shall be deemed to be income of Mr. C for the previous year 2017-18. Since the repayment of the same along with interest was made by way of account payee cheque, the same would not be hit by the provisions of section 69D. Therefore, the action of the Assessing Officer treating the amount borrowed as income during the previous year is valid in law.

Question 6

The Assessing Officer found, during the course of assessment of a firm, that it had paid rent in respect of its business premises amounting to Rs.60,000, which was not debited in the books of account for the year ending 31.3.2018. The firm did not explain the source for payment of rent. The Assessing Officer proposes to make an addition of Rs.60,000 in the hands of the firm for the assessment year

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2018-19. The firm claims that even if the addition is made, the sum of Rs.60,000 should be allowed as deduction while computing its business income since it has been expended for purposes of its business. Examine the claim of the firm.

Answer

The claim of the firm for deduction of the sum of Rs.60,000 in computing its business income is not tenable. The action of the Assessing Officer in making the addition of Rs.60,000, being the payment of rent not debited in the books of account (for which the firm failed to explain the source of payment) is correct in law since the same is an unexplained expenditure under section 69C. The proviso to section 69C states that such unexplained expenditure, which is deemed to be the income of the assessee, shall not be allowed as a deduction under any head of income. Therefore, the claim of the firm is not tenable

SIGNIFICANT SELECT CASES

1. **What is the nature of liquidated damages received by a company from the supplier of plant for failure to supply machinery to the company within the stipulated time – a capital receipt or a revenue receipt?**

   CIT v. Saurashtra Cement Ltd. (2010) 325 ITR 422 (SC)

   Facts of the case: The assessee, a cement manufacturing company, entered into an agreement with a supplier for purchase of additional cement plant. One of the conditions in the agreement was that if the supplier failed to supply the machinery within the stipulated time, the assessee would be compensated at 5% of the price of the respective portion of the machinery without proof of actual loss. The assessee received Rs.8.50 lakhs from the supplier by way of liquidated damages on account of his failure to supply the machinery within the stipulated time. The Department assessed the amount of liquidated damages to income-tax. However, the Appellate Tribunal held that the amount was a capital receipt and the High Court concurred with this view.

   Supreme Court's Decision: The Apex Court affirmed the decision of the High Court holding that the damages were directly and intimately linked with the procurement of a capital asset i.e., the cement plant, which lead to delay in coming into existence of the profit-making apparatus. It was not a receipt in the course of profit earning process. Therefore, the amount received by the assessee towards compensation for sterilization of the profit earning source, is not in the ordinary course of business, hence it is a capital receipt in the hands of the assessee.

2. **Can capital contribution of the individual partners credited to their accounts in the books of the firm be taxed as cash credit in the hands of the firm, where the partners**

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have admitted their capital contribution but failed to explain satisfactorily the source of receipt in their individual hands?

CIT v. M. Venkateswara Rao (2015) 370 ITR 212 (T & AP)

Facts of the case: The assessee-firm was constituted in the year 1982 and its return for the assessment year 1993-94 was selected for scrutiny under section 143(3). The controversy was in relation to the capital contribution of ten partners aggregating to Rs.76.57 lakhs. The assessee-firm's explanation that the partners have paid various amounts towards contribution of their share in the capital was not accepted since the source of income for the partners was not explained. The Commissioner (Appeals) observed that the amounts credited in the names of four partners were valid and that cash credits in the accounts of six other partners in the books of the firm were to be considered afresh by the Assessing Officer.

Issue under consideration: The issue before the High Court was whether the Assessing Officer was justified in treating the capital contribution of partners as income of the firm by invoking section 68? **High Court's Opinion:** Section 68 directs that if an assessee fails to explain the nature and source of credit entered in the books of account of any previous year, the same can be treated as income. In this case, the amount sought to be treated as income of the firm is the contribution made by the partners to the capital. In a way, the amount so contributed constitutes the very substratum for the business of the firm and it is difficult to treat the pooling of such capital as credit. It is only when the entries are made during the course of business, they can be subjected to scrutiny under section 68.

Where the firm explains that the partners have contributed capital, section 68 cannot be pressed into service. At the most, the Assessing Officer can make an enquiry against the individual partners and not the firm when the partners have also admitted their capital contributionin the firm. The High Court made reference to decision in the case of CIT v. Anupam Udyog 142 ITR 130 (Patna) where it was held if there are cash credits in the books of the firm in the accounts of the individual partners and it is found as a fact that cash was received by the firm from its partner, then, in the absence of any material to indicate that they are the profits of the firm, the cash credits cannot be assessed in the hands of the firm, though they may be assessed in the hands of individual partners.[8]

High Court's Decision: The High Court, accordingly, held that the view taken by the Assessing Officer that the partnership firm has to explain the source of income of the partners as regards the amount contributed by them towards capital of the firm, in the absence of which the same would be treated as the income of the firm, was not tenable.

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Illustration 1

Mr. Anand is an Indian citizen and a member of the crew of a Singapore bound Indian ship engaged in carriage of passengers in international traffic departing from Chennai port on 6th June, 2017. From the following details for the P.Y.2017-18, determine the residential status of Mr. Anand for A.Y.2018-19, assuming that his stay in India in the last 4 previous years (preceding P.Y.2017-18) is 400 days and last seven previous years (preceding P.Y.2017-18) is 750 days:

Particulars	*Date*
Date entered into the Continuous Discharge Certificate in respect of joining the ship by Mr. Anand	*6th June, 2017*
Date entered into the Continuous Discharge Certificate in respect of signing off the ship by Mr. Anand	*9th December, 2017*

Solution

In this case, the voyage is undertaken by an Indian ship engaged in the carriage of passengers in international traffic, originating from a port in India (i.e., the Chennai port) and having its destination at a port outside India (i.e., the Singapore port). Hence, the voyage is an eligible voyage for the purposes of section 6(1).

Therefore, the period beginning from 6th June, 2017 and ending on 9th December, 2017, being the dates entered into the Continuous Discharge Certificate in respect of joining the ship and signing off from the ship by Mr. Anand, an Indian citizen who is a member of the crew of the ship, has to be excluded for computing the period of his stay in India. Accordingly, 187 days [25+31+31+30+31+30+9] have to be excluded from the period of his stay in India. Consequently, Mr. Anand's period of stay in India during the P.Y.2017-18 would be 178 days [i.e., 365 days – 187 days]. Since his period of stay in India during the P.Y.2017-18 is less than 182 days, he is a non-resident for A.Y.2018-19.

Note - Since the residential status of Mr. Anand is "non-resident" for A.Y.2018-19 consequent to his number of days of stay in P.Y.2017-18 being less than 182 days, his period of stay in the earlier previous years become irrelevant.

Illustration 2

Brett Lee, an Australian cricket player visits India for 100 days in every financial year. This has been his practice for the past 10 financial years. Find out his residential status for the assessment year 2018-19.

Solution

Determination of Residential Status of Mr. Brett Lee for the A.Y. 2018-19:-

Period of stay during previous year 2017-18 = 100 days

Calculation of period of stay during 4 preceding previous years (100 x 4=400 days)

2016-17 9 100 days

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2015-16	100 days
2014-15	100 days
2013-14	100 days
Total	**400 days**

Mr. Brett Lee has been in India for a period more than 60 days during previous year 2017-18 and for a period of more than 365 days during the 4 immediately preceding previous years. Therefore, since he satisfies one of the basic conditions under section 6(1), he is a resident for the assessment year 2018-19.

Computation of period of stay during 7 preceding previous years = 100 x 7=700 days

2016-17	100 days
2015-16	100 days
2014-15	100 days
2013-14	100 days
2012-13	100 days
2011-12	100 days
2010-11	100 days
Total	**700 days**

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Since his period of stay in India during the past 7 previous years is less than 730 days, he is a not-ordinarily resident during the assessment year 2018-19. (See Note below)

Therefore, Mr. Brett Lee is a resident but not ordinarily resident during the previous year 2017-18 relevant to the assessment year 2018-19.

Note: A not-ordinarily resident person is one who satisfies any one of the conditions specified under section 6(6), i.e.,

(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.

In this case, since Mr. Brett Lee satisfies condition (ii), he is a not-ordinary resident for the A.Y. 2018-19.

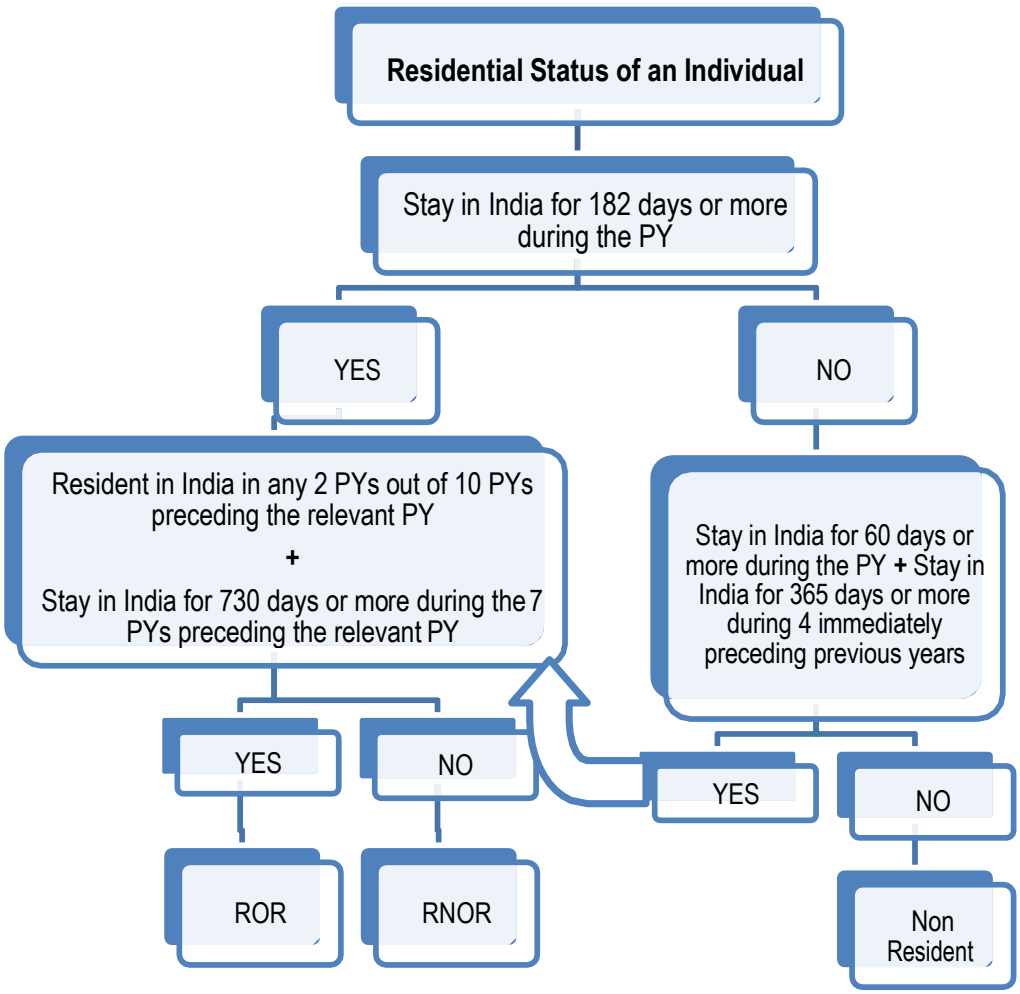


Illustration 3

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.2017-18 after 15 years. He comes to India on 1.4.2017 and leaves for Australia on 1.12.2017. Determine the residential status of

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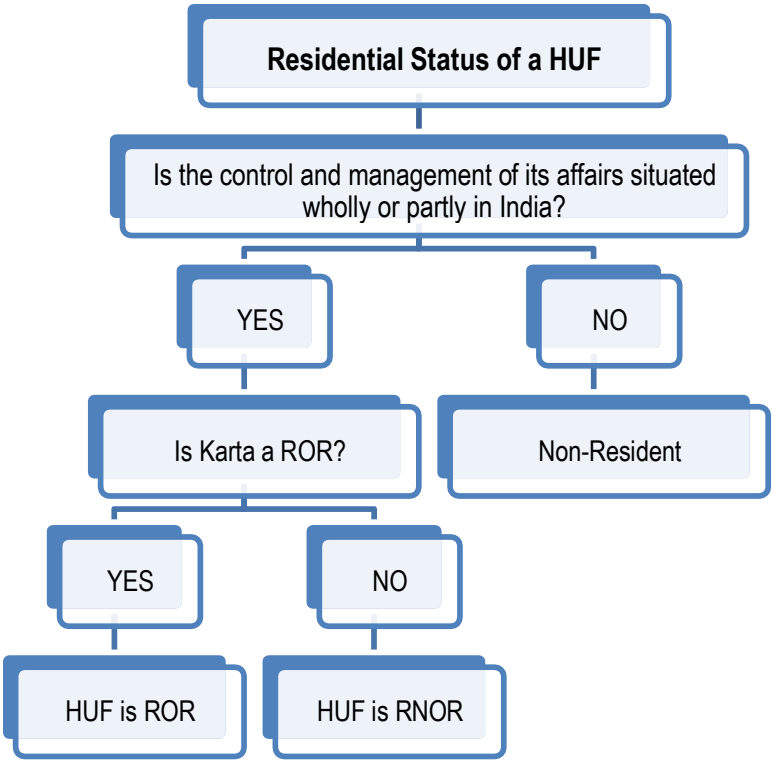
Mr. E and the HUF for A.Y. 2018-19.

Solution

(a) During the P.Y.2017-18, 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 does not satisfy any of the conditions for being ordinarily resident.

Therefore, the residential status of Mr. E for the P.Y.2017-18 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.2017-18.



Example 1: Company A Co. is a sourcing entity, for an Indian multinational group, incorporated in country X and is 100% subsidiary of Indian company (B Co.). The warehouses and stock in them are the only assets of the company and are located in country X. All the employees of the company are also in country X. The average income wise breakup of the company's total income for three years is, -

(i) 30% of income is from transaction where purchases are made from parties which are non-associated enterprises and sold to associated enterprises;

(ii) 30% of income is from transaction where purchases are made from associated enterprises and sold to associated enterprises;

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(iii) 30% of income is from transaction where purchases are made from associated enterprises and sold to non-associated enterprises; and

(iv) 10% of the income is by way of interest.

Interpretation: In this case passive income is 40% of the total income of the company. The passive income consists of, -

(i) 30% income from the transaction where both purchase and sale is from/to associated enterprises; and

(ii) 10% income from interest.

The A Co. satisfies the first requirement of the test of active business outside India. Since no assets or employees of A Co. are in India the other requirements of the test is also satisfied. Therefore, company is engaged in active business outside India.

Example 2: The other facts remain same as that in Example 1 with the variation that A Co. has a total of 50 employees. 47 employees, managing the warehouse, storekeeping and accounts of the company, are located in country X. The Managing Director (MD), Chief Executive Officer (CEO) and sales head are resident in India. The total annual payroll expenditure on these 50 employees is of ` 5 crore. The annual payroll expenditure in respect of MD, CEO and sales head is of ` 3 crore.

Interpretation: Although the first limb of active business test is satisfied by A Co. as only 40% of its total income is passive in nature. Further, more than 50% of the employees are also situated outside India. All the assets are situated outside India. However, the payroll expenditure in respect of the MD, the CEO and the sales head being employees resident in India exceeds 50% of the total payroll expenditure. Therefore, A Co. is not engaged in active business outside India.

Example 3: The basic facts are same as in Example 1. Further facts are that all the directors of the A Co. are Indian residents. During the relevant previous year 5 meetings of the Board of Directors is held of which two were held in India and 3 outside India with two in country X and one in country Y.

Interpretation: The A Co. is engaged in active business outside India as the facts indicated in Example 1 establish. The majority of board meetings have been held outside India. Therefore, the POEM of A Co. shall be presumed to be outside India.

Example 4: The facts are same as in Example 3 but it is established by the Assessing Officer that although A Co.'s senior management team signs all the contracts, for all the contracts above ` 10 lakh the A Co. must submit its recommendation to B Co. and B Co. makes the decision whether or not the contract may be accepted. It is also seen that during the previous year more than 99% of the contracts are above ` 10 lakh and over past years also the same trend in respect of value contribution of contracts above ` 10 lakh is seen.

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Interpretation: These facts suggest that the effective management of the A Co. may have been usurped by the parent company B Co. Therefore, POEM of A Co. may in such cases be not presumed to be outside India even though A Co. is engaged in active business outside India and majority of board meeting are held outside India.

Example 5: An Indian multinational group has a local holding company A Co. in country X. The A Co. also has 100% downstream subsidiaries B Co. and C Co. in country X and D Co. in country Y. The A Co. has income only by way of dividend and interest from investments made in its subsidiaries. The Place of Effective Management of A Co. is in India and is exercised by ultimate parent company of the group. The subsidiaries B, C and D are engaged in active business outside India. The meetings of Board of Director of B Co., C Co. and D Co. are held in country X and Y respectively.

Interpretation: Merely because the POEM of an intermediate holding company is in India, the POEM of its subsidiaries shall not be taken to be in India. Each subsidiary has to be examined separately. As indicated in the facts since companies B Co., C Co., and D Co. are independently engaged in active business outside India and majority of Board meetings of these companies are also held outside India. The POEM of B Co., C Co., and D Co. shall be presumed to be outside India.

Illustration 4

Further, the CBDT vide Circular no. 8/2017 dated 23.02.2017 also clarified that POEM guidelines shall not apply to a company having turnover or gross receipts of ` 50 crores or less in a financial year.

ABC Inc., a Swedish company headquartered at Stockholm, not having a permanent establishment in India, has set up a liaison office in Mumbai in April, 2017 in compliance with RBI guidelines to look after its day to day business operations in India, spread awareness about the company's products and explore further opportunities. The liaison office takes decisions relating to day to day routine operations and performs support functions that are preparatory and auxiliary in nature. The significant management and commercial decisions are, however, in substance made by the Board of Directors at Sweden. Determine the residential status of ABC Inc. for A.Y. 2018-19.

Solution

Section 6(3) provide that a company would be resident in India in any previous year, if-

(i) it is an Indian company; or

(ii) its place of effective management, in that year, is in India .

In this case, ABC Inc. is a foreign company. Therefore, it would be resident in India for P.Y.2017-18 only if its place of effective management, in that year, is in India.

Explanation to section 6(3) defines "place of effective management" to mean a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance made. In the case of ABC Inc., its place of effective management for P.Y.2017-18 is not in India, since the significant management and commercial decisions are, in substance, made by the Board of Directors outside India in Sweden.

ABC Inc. has only a liaison office in India through which it looks after its routine day to day business operations in India. The place where decisions relating to day to day routine operations are taken

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and support functions that are preparatory or auxiliary in nature are performed are not relevant in determining the place of effective management.

Hence, ABC Inc., being a foreign company is a non-resident for A.Y.2018-19, since its place of effective management is outside India in the P.Y.2017-18.

Illustration 5

From the following particulars of income furnished by Mr. Anirudh pertaining to the year ended 31.3.2018, compute the total income for the assessment year 2018-19, if he is:

(i) Resident and ordinary resident;

(ii) Resident but not ordinarily resident;

(iii) Non-resident

	Particulars	`
(a)	*Short term capital gain on sale of shares in Indian Company received in Germany*	*15,000*
(b)	*Dividend from a Japanese Company received in Japan*	*10,000*
(c)	*Rent from property in London deposited in a bank in London, later on remitted to India through approved banking channels*	*75,000*
(d)	*Dividend from RP Ltd., an Indian Company*	*6,000*
(e)	*Agricultural income from lands in Gujarat*	*25,000*

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Solution

Computation of total income of Mr. Anirudh for the A.Y. 2018-19

Particulars	Resident & ordinarily resident (`)	Resident but not ordinarily resident (`)	Non-Resident (`)
1) Short term capital gain on sale of shares of an Indian company, received in Germany	15,000	15,000	15,000
2) Dividend from a Japanese company, received in Japan	10,000	-	-
3) Rent from property in London deposited in a bank in London **[See Note (i) below]**	52,500	-	-
4) Dividend from RP Ltd., an Indian Company **[See Note (ii) below]**	-	-	-
5) Agricultural income from land in Gujarat **[See Note (iii) below]**	-	-	-
Total Income	**77,500**	**15,000**	**15,000**

Notes:

(i) It has been assumed that the rental income is the gross annual value of the property. Therefore, deduction @30% under section 24, has been provided and the net income so computed is taken into account for determining the total income of a resident and ordinarily resident.

Particulars	`
Rent received (assumed as gross annual value)	75,000
Less: Deduction under section 24 (30% of `75,000)	22,500
Income from house property	52,500

(ii) Dividend from Indian company is exempt under section 10(34).

(iii) Agricultural income is exempt under section 10(1).

Illustration 6

J, a citizen of India, employed in the Indian Embassy at Tokyo, Japan. He received salary and allowances at Tokyo from the Government of India for the year ended 31.3.2018 for services rendered by him in Tokyo. Besides, he was allowed perquisites by the Government. He is a non- resident for the assessment year 2018-19. Examine the taxability of salary, allowances and perquisites in the hands of

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J for the assessment year 2018-19.

Solution

As per section 9(1)(iii), salaries payable by the Government to a citizen of India for services rendered outside India shall be deemed to accrue or arise in India. As such, salary received by J is chargeable to tax, even though he was a non-resident for A.Y. 2018-19.

As per section 10(7), all allowances or perquisites paid or allowed as such outside India by the Government to a citizen of India for rendering services outside India is exempt from tax. Therefore, the allowances and perquisites received by J are exempt as per section 10(7).

Illustration 7

Mr. Soham, an Indian Citizen, left India on 20-04-2015 for the first time to setup a software firm in Singapore. On 10-04-2017, he entered into an agreement with LK Limited, an Indian Company, for the transfer of technical documents and designs to setup an automobile factory in Faridabad. He reached India along with his team to render the requisite services on 15-05-2017 and was able to complete his assignment on 20-08-2017. He left for Singapore on 21-08-2017. He charged ` 50 lakhs for his services from LK Limited.

Determine the residential status of Mr. Soham for the Assessment Year 2018-19 and examine whether the fees charged from LK Limited would be chargeable to tax as per the Income-tax Act, 1961.

Solution

Determination of residential status of Mr. Soham

As per section 6(1), an individual is said to be resident in India in any previous year if he satisfies the 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.

In the case of an Indian citizen leaving India for the purposes of employment outside India during the previous year or an Indian citizen, who being outside India, comes on a visit to India in any previous year, the period of stay during the previous year in condition (ii) above, to qualify as a resident, would be 182 days instead of 60 days.

In this case, Mr. Soham is an Indian citizen who left India to set up a software firm in Singapore on 20.04.2015. Therefore, he is an Indian citizen living in Singapore, who comes on a visit to India during the P.Y.2017-18. His stay in India during the period of his visit is only 99 days (i.e., 17+30+31+21 days). Since his stay in India during the previous year 2017-18 is only 99 days, he does not satisfy the minimum criterion of 182 days stay in India for being a resident. Hence, his residential status for A.Y.2018-19 is Non-Resident.

Taxability of income

As per section 5(2), in case of a non-resident, only income which accrues or arises or which is deemed to accrue or arise to him in India or which is received or deemed to be received in India in the relevant previous year is taxable in India.

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In this case, Mr. Soham, a non-resident, charges fees from LK Ltd., an Indian company, for transfer of technical documents and designs to set up an automobile factory in Faridabad. He renders the requisite services in India for which he stays in India for 99 days during the P.Y.2017-18.

Section 9(1)(vi) defines "royalty" to mean consideration for transfer of all or any rights in respect of, inter alia, a design and also for the rendering of services in connection with such activity. Transfer of rights in the above definition includes transfer of right for use or right to use a computer software also. Therefore, the fees received by Mr. Soham for transfer of technical documents and designs and rendering of requisite services in relation thereto would fall within the meaning of "royalty".

As per section 9(1)(vi), income by way of royalty payable by a person who is a resident (in this case, LK Limited, an Indian company) would be deemed to accrue or arise in India in the hands of the non-resident (Mr. Soham, in this case), except where such royalty is payable in respect of any right or property or information used or for services utilized for the purpose of a business carried on by such person outside India or for the purposes of making or earning income from any source outside India.

In this case, since the royalty is payable by an Indian company to Mr. Soham, a non-resident, in respect of services utilized for a business in India (namely, for setting up an automobile factory in Faridabad), the same is deemed to accrue or arise in India and is hence, taxable in India in the hands of Mr. Soham, a non-resident for the A.Y. 2018-19.

Illustration 8

Miss Vivitha paid a sum of 5000 USD to Mr. Kulasekhara, a management consultant practising in Colombo, specializing in project financing. The payment was made in Colombo. Mr. Kulasekhara is a non-resident. The consultancy is related to a project in India with possible Ceylonese collaboration. Is this payment chargeable to tax in India in the hands of Mr. Kulasekhara, since the services were used in India?

Solution

A non-resident is chargeable to tax in respect of income received outside India only if such income accrues or arises or is deemed to accrue or arise to him in India.

The income deemed to accrue or arise in India under section 9 comprises, inter alia, income by way of fees for technical services, which includes any consideration for rendering of any managerial, technical or consultancy services. Therefore, payment to a management consultant relating to project financing is covered within the scope of "fees for technical services".

The Explanation below section 9(2) clarifies that income by way of, inter alia, fees for technical services, 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 or whether or not the non-resident has a residence or place of business or business connection in India.

In the instant case, since the services were utilized in India, the payment received by Mr. Kulasekhara, a non-resident, in Colombo is chargeable to tax in his hands in India, as it is deemed

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to accrue or arise in India.

Illustration 9

Compute the total income in the hands of an individual, being a resident and ordinarily resident, resident but not ordinarily resident, and non-resident for the A.Y. 2018 -19:

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
Income from house property in London deposited in a Indian Bank at London, brought to India (Computed)	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
Income from property situated in Pakistan received there	16,000
Past foreign untaxed income brought to India during the previous year	5,000
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
Gift received on the occasion of his wedding	20,000
Interest on savings bank deposit in State Bank of India	12,000
Income from a business in Russia, controlled from Russia	20,000
Dividend from Reliance Petroleum Limited, an Indian Company	5,000
Agricultural income from a land in Rajasthan	15,000

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Solution

Computation of total income for the A.Y. 2018-19

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
Income 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

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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 taxable]**	-	-	-
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**

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EXERCISE

Question 1

Peeyush, returned to India on 12th June, 2017 for permanently residing in India after a stay of about 20 years in U.K., provides the sources of his various income and seeks your opinion to know about his liability to income tax thereon in India in assessment year 2018-19:

(i) Income of rent of the flat in London which was deposited in a bank there. The flat was given on rent by him after his return to India since July, 2017.

(ii) Dividends on the shares of three German Companies which are being collected in a bank account in London. He proposes to keep the dividend on shares in London with the permission of the Reserve Bank of India.

(iii) He has got two sons, one of whom is of 12 years and other 19 years. Both his sons are staying in London and not returning to India with him. Each of his sons is having income of ` 75,000 in U.K. in foreign currency (not received in India) and of ` 20,000 in India.

(iv) During the preceding accounting year when he was a non-resident, he had sold 1000 shares which were acquired by him in British Pound Sterling and the sale proceeds were repatriated. The profit in terms of British Pound Sterling on sale of these 1000 shares was 175% of the cost at ` 37,500 while in terms of Indian Rupee it was ` 50,000.

Answer

Peeyush returned to India on 12th June 2017 for permanently residing in India after staying in UK for 20 years. During the P.Y.2017-18, he stays in India for 293 days. Since he has stayed in India for a period of 182 days or more during the previous year 2017-18, he would be a resident in India for the A.Y.2018-19. However, he would be a resident but not ordinarily resident, assuming that he was a non-resident in nine out of ten previous years preceding P.Y.2017-18 and his stay in India during the seven previous years is less than 730 days. The residential status of Peeyush for A.Y.2018-19 is, therefore, **Resident but Not Ordinarily Resident.**

As per section 5(1), only income which is received/deemed to be received/accrued or arisen/deemed to accrue or arise in India is taxable in case of a Resident but not Ordinarily Resident. Income which accrues or arises outside India shall not be included in his total income, unless it is derived from a business controlled in, or a profession set up in, India.

(i) Rental income from a flat in London which was deposited in a bank there shall not be taxable in the case of a resident but not ordinarily resident, since both the accrual and receipt of income are outside India.

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(ii) Dividends from shares of three German Companies, collected in a bank account in London, would also not be taxable in the case of a resident but not ordinarily resident since both the accrual and receipt of income are outside India.

(iii) As per section 64(1A), all income accruing or arising to a minor child is includible in the hands of the parent, after providing for deduction of ` 1,500 per child under section 10(32).

Accordingly, income of ` 20,000 accruing to his minor son, aged 12 years, in India is includible in the income of Peeyush, after providing deduction of ` 1,500. Therefore, `18,500 is includible in the income of Peeyush. Income accruing to the minor child outside India (which is also received outside India) is not includible in the income of Peeyush.

Since the other son is major, his income is not includible in the income of Peeyush.

(iv) Repatriation of sale proceeds of 1000 shares sold in the preceding accounting year, when Peeyush was a non-resident, is not taxable in the A.Y.2018-19 since it is not the income of the P.Y.2017-18.

Consequently, only the income includible under section 64(1A) would form part of the total income of Mr. Peeyush for A.Y.2018-19. Since his total income(i.e., ` 18,500) is less than the basic exemption limit, there would be no liability to income-tax for A.Y.2018-19.

Question 2

Mr. David, a Government employee serving in the Ministry of External Affairs, left India for the first time on 31.03.2017 due to his transfer to High Commission of Canada. He did not visit India any time during the previous year 2017-18. He has received the following income for the Financial Year 2017-18:

S.No.	Particulars	`
(i)	Salary	5,00,000
(ii)	Foreign Allowance	4,00,000
(iii)	Interest on fixed deposit from bank in India	1,00,000
(iv)	Income from agriculture in Pakistan	2,00,000
(v)	Income from house property in Pakistan	2,50,000

Compute his gross total income for Assessment Year 2018-19.

Answer

As per section 6(1), Mr. David is a non-resident for the A.Y. 2018-19, since he was not present in India at any time during the previous year 2017-18.

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As per section 5(2), a non-resident is chargeable to tax in India only in respect of following incomes:

(i) Income received or deemed to be received in India; and

(ii) Income accruing or arising or deemed to accrue or arise in India.

In view of the above provisions, income from agriculture in Pakistan and income from house property in Pakistan would not be chargeable to tax in the hands of David, assuming that the same were received in Pakistan.

Income from 'Salaries' payable by the Government to a citizen of India for services rendered outside India is deemed to accrue or arise in India as per section 9(1)(iii). Hence, such income is taxable in the hands of Mr. David, even though he is a non-resident. It has been assumed that Mr. David is a citizen of India.

However, allowances or perquisites paid or allowed as such outside India by the Government to a citizen of India for rendering service outside India is exempt under section 10(7). Hence, foreign allowance of ` 4,00,000 is exempt under section 10(7).

Gross Total Income of Mr. David for A.Y. 2018-19

Particulars	`
Salaries	5,00,000
Income from other sources (Interest on fixed deposit in India)	1,00,000
Gross Total Income	**6,00,000**

Question 3

Mr. A, a citizen of India, left for USA for the purposes of employment on 1.5.2017. He has not visited India thereafter. Mr. A borrows money from his friend Mr. B, who left India one week before Mr. A's departure, to the extent of ` 10 lakhs and buys shares in X Ltd., an Indian company. Discuss the taxability of the interest charged @10% in B's hands where the same has been received in New York.

Answer

An individual is said to be resident in India in any previous year, if he -

(i) has been in India during that year for a total period of 182 days or more, or

(ii) has been in India during the four years immediately preceding that year for a total period of 365 days or more and has been in India for at least 60 days in that year.

In this case, A has been in India only from 1.4.2017 to 30.04.2017 i.e. for 30 days. Therefore,

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he does not satisfy either of the conditions in (i) or (ii) and is, hence, a non-resident. B, who left India one week before A's departure, is also a non-resident for the same reasons.

Section 9(1)(v) provides that income by way of interest payable by a non-resident in respect of any debt incurred, or moneys borrowed and used, for the purposes of a business or profession carried on by such person in India shall be deemed to accrue or arise in India.

Therefore, interest payable by a non-resident in respect of any debt incurred, or moneys borrowed and used, for the purpose of making or earning any income from any source other than a business or profession carried on by him in India, shall not be deemed to accrue or arise in India. Therefore, interest payable by A on money borrowed from B to invest in shares of an Indian company shall not be deemed to accrue or arise in India and hence, is not taxable in India in the hands of B.

Question 4

Poulomi, a chartered accountant, is presently working in a firm in India. She has received an offer for the post of Chief Financial Officer from a company at Singapore. As per the offer letter, she should join the company at any time between 1st September, 2017 and 31st October, 2017. She approaches you for your advice on the following issues to mitigate her tax liability in India:

(i) Date by which she should leave India to join the company;

(ii) Direct credit of part of her salary to her bank account in Kolkata maintained jointly with her mother to meet requirement of her family

(iii) Period for which she should stay in India when she comes on leave.

Answer

The following category of individuals will be treated as resident in India only if the period of their stay in India during the relevant previous year is 182 days or more :-

(a) Indian citizens, who leave India in any previous year, inter alia, for purposes of employment outside India, or

(b) Indian citizen or person of Indian origin engaged outside India, inter alia, in an employment, who comes on a visit to India in any previous year.

(i) Since Poulomi is leaving India for the purpose of employment outside India, she will be treated as resident only if the period of her stay during the previous year amounts to 182 days or more. Therefore, Poulomi should leave India on or before 28th September, 2017, in which case, her stay in India during the previous year would be less than 182 days and she would become non-resident for the purpose of taxability in India. In such a case, only the income which accrues or arises in India or which is deemed to accrue or arise in India or received or deemed to be received in India shall be taxable.

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The income earned by her in Singapore would not be chargeable to tax in India for A.Y. 2018-19, if she leaves India on or before 28th September, 2017.

(ii) If any part of Poulomi's salary will be credited directly to her bank account in Kolkata then, that part of her salary would be considered as income received in India during the previous year under section 5 and would be chargeable to tax under Income-tax Act, 1961, even if she is a non-resident. Therefore, Poulomi should receive her entire salary in Singapore and then remit the required amount to her bank account in Kolkata in which case, the salary earned by her in Singapore would not be subject to tax in India.

(iii) In case Poulomi visits India after taking up employment outside India, she would be covered in the exception provided in (b) above and she will be treated as resident only if the period of her stay during the relevant previous year amounts to 182 days or more.

Therefore, when Poulomi comes India on leave, she should stay in India for less than 182 days during the relevant previous year so that her status remains as a non-resident for the relevant previous year. Moreover, she should not visit India again during the current previous year i.e. P.Y. 2017-18.

SIGNIFICANT SELECT CASES

Can consideration for supply of software embedded in hardware tantamount to 'royalty' under section 9(1)(vi), where the software was no independent functional existence?

CIT v. Alcatel Lucent Canada (2015) 372 ITR 476 (Del)

Facts of the case: The assessee, a company incorporated in France, was engaged in manufacture, trade and supply equipment and services for GSM Cellular Radio Telephones Systems. It supplied hardware and software to various entities in India. Software licensed by the assessee embodied the process which is required to control and manage the specific set of activities involved in the business use of its customers, and also made available the process to its customers, who used it to carry out their business activities. The Assessing Officer contended that the consideration for supply of software embedded in hardware is 'royalty' under section 9(1)(vi).

Appellate Authorities' Views: The Commissioner (Appeals) and Tribunal held that the consideration for supply of embedded software (which is part of the hardware supplied to the assessee customers) did not constitute royalty and therefore, section 9(1)(vi) was not attracted.

High Court's Observations: The High Court, at the outset, noted that the Tribunal had relied upon the precedent in the case of DIT v. Ericsson A.B. (2012) 343 ITR 470 (Del), where the High Court observed that what was sold by the assessee to its Indian customers was a GSM which consisted of both hardware and software. The High Court had also observed that -

(i) the software that was loaded on the hardware did not have any independent existence;

(ii) the software supply is an integral part of GSM mobile telephone system and is used by the cellular operators for providing cellular services to its customers;

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(iii) the software is embedded in the system and there could not be any independent use of such software;

(iv) this software merely facilitates the functioning of the equipment and is an integral part of the hardware.

Further, the High Court had also referred the decision of the Apex Court in Tata Consultancy Services v. State of Andhra Pradesh (2004) 271 ITR 401, wherein it was held that software incorporated on a media would be goods liable to sales tax.

High Court's Decision: The High Court concurred with the decision of the Tribunal holding that where payment is made for hardware in which the software is embedded and the software does not have independent functional existence, no amount could be attributed as 'royalty' for software in terms of section 9(1)(vi).

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Illustration 1

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

Business income = Sales (-) Market value of 70% of sugarcane produce(-) Manufacturing expenses

= Rs. 25 lacs (-) Rs. 22 lacs (-) Rs. 1.5 lacs = Rs. 1.5 lacs.

Agricultural income = Market value of sugarcane produce (-) Cost of cultivation

= [Rs. 10 lacs + Rs. 22 lacs] (-) [Rs. 5 lacs + Rs. 14 lacs]

= Rs. 32 lacs (-) Rs. 19 lacs

= Rs. 13 lacs.

Illustration 2

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

Solution

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

Total profits from the sale of latex = Rs. 30 lacs – Rs. 10 lacs – Rs. 8 lacs = Rs. 12 lacs. Agricultural income = 65% of Rs. 12 lacs. = Rs. 7.8 lacs

Business income = 35% of Rs. 12 lacs. = Rs. 4.2 lacs

Illustration 3

Ankur, the owner of a land situated in Kerala used for growing thereon different types of fruits, paddy, vegetables and flowers, received from Yahoo Movies Ltd., Chennai, Rs. 5 lacs as rent towards the use of this land for shooting of a film. The amount so received was accounted by him in the books as revenue derived from land and claimed to be exempt under section 10(1). He now wants to confirm from you whether the amount has been correctly treated by him as agricultural income.

Solution

The income received by Mr. Ankur from a filmmaker for allowing them to shoot a film in the agricultural land owned by him is not in the nature of agricultural income because it was neither received by him against the sale of agricultural produce obtained nor for carrying out the normal agricultural operations

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on the land. The amount paid was only for the purpose of shooting of a film on such land.

To claim exemption in respect of agricultural income under section 10(1), the conditions contained in section 2(1A)(a) to (c) have to be first complied with/fulfilled by the assessee. The Madras High Court in the case of B. Nagi Reddi v. CIT (2002) 258 ITR 719, following the judgment of Apex Court in the case of CIT v Raja Benoy Kumar Sahas Roy (1957) 32 ITR 466, has held, on identical facts, that the income derived for allowing a shooting of film in the agricultural land cannot be treated as agricultural income, as it has no nexus with the land, except that it was carried out on agricultural land.

Partial integration of agricultural income with non-agricultural income

As in the above discussion, we have seen that agricultural income is exempt subject to conditions mentioned in the definition clause of section 2(1A). 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 agricultural income with non-agricultural income.** It is applicable to individuals, HUFs, AOPs, BOIs and artificial persons. Two conditions which need to be satisfied for partial integration are:

1. The net agricultural income should exceed Rs. 5,000 p.a., and
2. Non-agricultural income should exceed the maximum amount not chargeable to tax. (i.e., Rs. 5,00,000 for resident very senior citizens, Rs. 3,00,000 for resident senior citizens, Rs. 2,50,000 for all other individuals and HUFs).

It may be noted that aggregation provisions do not apply to company, LLP, firm, 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., Rs. 2,50,000 / Rs. 3,00,000/ Rs. 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 surcharge, if applicable. It would be reduced by the rebate if any available u/s 87A.

Step 5: Thereafter, it would be increase by education cess @2% and secondary and higher education cess @1%.

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

Illustration 4

Mr. X, a resident, has provided the following particulars of his income for the P.Y.2017-18.

i. Income from salary (computed) - Rs.1,80,000

ii. Income from house property (computed) - Rs.2,00,000

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iii. Agricultural income from a land in Jaipur - Rs.2,80,000

iv. Expenses incurred for earning agricultural income -

Rs.1,70,000 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. 2018-19

(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 Rs. 5,000 p.a., and
2. Non-agricultural income exceeds the basic exemption limit of Rs. 2,50,000.

His tax liability is computed in the following manner:

Particulars	`	`
Income from salary		1,80,000
Income from house property		2,00,000
Net agricultural income [Rs. 2,80,000 (-) Rs. 1,70,000]	1,10,000	
Less: Exempt under section 10(1)	(1,10,000)	-
Gross Total Income		**3,80,000**
Less: Deductions under Chapter VI-A		-
Total Income		**3,80,000**

Step 1 :Rs. 3,80,000 + Rs. 1,10,000 = Rs. 4,90,000

Tax on Rs. 4,90,000 = Rs. 12,000

Step 2 :Rs. 1,10,000 + Rs. 2,50,000 = Rs. 3,60,000

Tax on Rs. 3,60,000 = Rs. 5,500 (i.e. 5% of Rs. 1,10,000)

Step 3 :Rs. 12,000 – Rs. 5,500 = Rs. 6,500

Step 4 & 5 : Total tax payable = Rs. 6,500

= Rs. 6,500 + 2% of Rs. 6,500 + 1% of Rs. 6,500 = Rs. 6,695.

(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 Rs. 5,000 p.a., and
2. Non-agricultural income exceeds the basic exemption limit of Rs. 3,00,000.

His tax liability is computed in the following manner:

Step 1 :Rs. 3,80,000 + Rs. 1,10,000 = Rs. 4,90,000.

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	Tax on Rs. 4,90,000	= Rs. 9,500 (i.e. 5% of Rs. 1,90,000)
Step 2	:Rs. 1,10,000 + Rs. 3,00,000	= Rs. 4,10,000.
	Tax on Rs. 4,10,000	= Rs. 5,500 (i.e. 5% of Rs. 1,10,000)
Step 3	:Rs. 9,500 – Rs. 5,500	= Rs. 4,000.
Step 4 & 5	: Total tax payable	= Rs. 4,000
		= Rs. 4,000 + 2% of Rs. 4,000 + 1% of Rs. 4,000 = Rs. 4,120.

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

Illustration 5

An amount of Rs.5 lacs was paid on 17.3.2018 to the parents of Amit by the Government of Chattisgarh as compensation to the aggrieved family, whose only son Amit lost his life in Maoist local bus bomb blast in Dantewada.

Examine with reasons, whether the amount of compensation received is chargeable to tax in A.Y. 2018-19?

Solution

As per section 10(10BC), the meaning of "disaster" shall be derived from Disaster Management

Act, 2005 which defines disaster to mean 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 substantial loss of life or human suffering or damage to, and destruction of property, or damage to, or degradation of environment. It should be of such a nature or magnitude to be beyond the coping capacity of the community of the affected area.

If, for this reason, any compensation is paid by the Central Government or by a State Government or by a local authority, then the same will be exempt from tax. Accordingly, the amount of Rs. 5 Lacs

received by the parents of deceased Amit from the Government of Chattisgarh for the disaster because of Dantewada bus bomb blast is exempt under section 10(10BC).

Illustration 6

Ms. J, a Sikkimese woman, married Mr. K, a non-Sikkimese, on 1st January, 2008. During the previous year 2017-18, she received rent of Rs.12 lacs from letting out of house properties situated in the State of Sikkim. Is she liable to income-tax for assessment year 2018-19? Will your answer be different, if she had married Mr. K on 16th April, 2008?

Solution

Section 10(26AAA) provides that the following income, which accrues or arises to a Sikkemese individual, shall be exempt from income-tax:

(a) Income from any source in the State of Sikkim; and

(b) Income by way of dividend or interest on securities.

However, the aforesaid exemption will not be available to a Sikkimese woman, who marries a non-Sikkemese individual on or after 1st April, 2008.

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Since Ms. J, the assessee, married Mr. K on 1st January, 2008, income derived by her by way of rent from properties situated in the State of Sikkim shall be exempt under section 10(26AAA).

However, if she had married Mr. K on 16th April, 2008, the exemption would not be available.

Note: The restriction in section 10(26AAA) applies only to Sikkimese women and not to men who are eligible for the exemption in respect of the above said incomes regardless of their marrying Sikkemese or non-Sikkemese women.

(36) Income of an Agricultural Produce Market Committee or Board [Section 10(26AAB)]

Illustration 7

Y Ltd. furnishes you the following information for the year ended 31.3.2018:

Particulars	Rs.(in lacs)
Total turnover of Unit A located in Special Economic Zone	100
Profit of the business of Unit A	30
Export turnover of Unit A	50
Total turnover of Unit B located in Domestic Tariff Area (DTA)	200
Profit of the business of Unit B	20

Compute deduction under section 10AA for the A.Y. 2018-19.

Solution

100% of the profit derived from export of articles or things or services is eligible for deduction under section 10AA, assuming that F.Y.2017-18 falls within the first five year period commencing from the year of manufacture or production of articles or things or provision of services by the Unit in SEZ.As per section 10AA(7), the profit derived from export of articles or things or services 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 articles or things or services bears to the total turnover of the business carried on by the undertaking.

Deduction under section 10AA

$$= \text{Profit of the business of Unit A} \times \frac{\text{Export Turnover of Unit A}}{\text{Total Turnover of Unit A}}$$

$$= \text{Rs. 30 lakhs} \times \frac{50}{100}$$

$$= \text{Rs. 15 lakhs}$$

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EXERCISE

Question 1

Examine with reasons, based on the provisions of the Act, as to chargeability of the following receipts to tax in the assessment year 2018-19:

(i) Rent of Rs.60,000 charged from tenants occupying houses constructed on the land situated in India and used for agricultural purposes.

(ii) Income of Rs.75,000 derived by Anand Nursery from the sale of seedlings grown without carrying out all the basic operations on land.

(ii) Mr. Gaitonde, born and brought up in the State of Sikkim, had a net profit of Rs.2,25,000 from the business located in Sikkim and interest of Rs.55,000 on the securities/ bonds issued by the Government of Rajasthan.

Answer

(i) As per section 10(1), agricultural income is exempt from tax. The meaning and scope of agricultural income is defined in section 2(1A). According to Explanation 2 to section 2(1A), any income derived from any building from the use of such building for any purpose (including letting for residential purposes or for the purpose of any business or profession) other than agriculture shall not be agricultural income. It appears in this case that the house was occupied by tenants for residential purposes. Therefore, the rent of Rs. 60,000 from letting out of houses constructed on agricultural land for residential purposes shall not be treated as agricultural income by virtue of Explanation 2 to section 2(1A). Hence, such income would be chargeable to tax.

(ii) Explanation 3 to section 2(1A) provides that the income derived from saplings or seedlings grown in a nursery shall be deemed to be agricultural income, whether or not the basic operations were carried out on land. Accordingly, the income of Rs. 75,000 derived by Anand Nursery from the sale of seedlings grown without carrying out all the basic operations on land shall be treated as agricultural income and exempt from tax under section 10(1).

(iii) Section 10(26AAA) exempts the income which accrues or arises to a Sikkimese individual from any source in the State of Sikkim and the income by way of dividend or interest on securities. Therefore, the income of Mr. Gaitonde from a business located in Sikkim and interest income on the securities/bonds of Government of Rajasthan shall not be subject to tax.

Question 2

Rudra Ltd. has one unit at Special Economic Zone (SEZ) and other unit at Domestic Tariff Area (DTA). The company provides the following details for the previous year 2017-18.

Particulars	Rudra Ltd. (Rs.)	Unit in DTA (Rs.)
Total Sales	6,00,00,000	2,00,00,000
Export Sales	4,60,00,000	1,60,00,000

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Net Profit	80,00,000	20,00,000

Calculate the eligible deduction under section 10AA of the Income-tax Act, 1961, for the Assessment Year 2018-19, in the following situations:

(i) If both the units were set up and start manufacturing from 22-05-2010.

(ii) If both the units were set up and start manufacturing from 14-05-2014.

Answer

Computation of deduction under section 10AA of the Income-tax Act, 1961

As per section 10AA, in computing the total income of Rudra Ltd. from its unit located in a Special Economic Zone (SEZ), which begins to manufacture or produce articles or things or provide any services during the previous year relevant to the assessment year commencing on or after 01.04.2006 but before 1st April 2021, there shall be allowed a deduction of 100% of the profit and gains derived from export of such articles or things or from services for a period of five 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, as the case may be, and 50% of such profits for further five assessment years subject to fulfillment of other conditions specified in section 10AA.

Computation of eligible deduction under section 10AA [See Working Note below]:

(i) <u>If Unit in SEZ was set up and began manufacturing from 22-05-2010:</u>

Since A.Y. 2018-19 is the 8th assessment year from A.Y. 2011-12, relevant to the previous year 2010-11, in which the SEZ unit began manufacturing of articles or things, it shall be eligible for deduction of 50% of the profits derived from export of such articles or things, assuming all the other conditions specified in section 10AA are fulfilled.

$$= \text{Profits of Unit in SEZ} \times \frac{\text{Export turnover of Unit in SEZ}}{\text{Total turnover of Unit in SEZ}} \times 50\%$$

$$= \text{`}60 \text{ lakhs} \times \frac{\text{Rs. } 300 \text{ lakhs}}{\text{Rs. } 400 \text{ lakhs}} \times 50\% = \text{Rs. } 22.50 \text{ lakhs}$$

(ii) <u>If Unit in SEZ was set up and began manufacturing from 14-05-2014:</u>

Since A.Y.2018-19 is the 4th assessment year from A.Y. 2015-16, relevant to the previous year 2014-15, in which the SEZ unit began manufacturing of articles or things, it shall be eligible for deduction of 100% of the profits derived from export of such articles or things, assuming all the other conditions specified in section 10AA are fulfilled.

$$= \text{Profits of Unit in SEZ} \times \frac{\text{Export turnover of Unit in SEZ}}{\text{Total turnover of Unit in SEZ}}$$

$$= \text{`}60 \text{ lakhs} \times \frac{\text{Rs. } 300 \text{ lakhs}}{34} \times 100\% = \text{Rs. } 45 \text{ lakhs}$$

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lakhs

x 100%

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The unit set up in Domestic Tariff Area is not eligible for the benefit of deduction under section 10AA in respect of its export profits, in both the situations.

Working Note:

Computation of total sales, export sales and net profit of unit in SEZ

Particulars	Rudra Ltd. (`)	Unit in DTA (`)	Unit in SEZ (`)
Total Sales	6,00,00,000	2,00,00,000	**4,00,00,000**
Export Sales	4,60,00,000	1,60,00,000	**3,00,00,000**
Net Profit	80,00,000	20,00,000	**60,00,000**

SIGNIFICANT SELECT CASES

Whether section 14A is applicable in respect of deductions, which are permissible and allowed under Chapter VI-A?

CIT v. Kribhco (2012) 349 ITR 0618 (Delhi)

Facts of the case: In the present case, the assessee is a co-operative society engaged in marketing of fertilizers and purchase and processing of seeds. The assessee had claimed deduction under section 80P(2)(d) on dividend income received from NAFED and co-operative bank and also on interest on deposits made with co-operative banks.

The Assessing Officer, relying upon section 14A, contended that the aforesaid income were not included in the total income of the assessee and therefore, expenditure with respect to such income should be disallowed.

High Court's Observations: The High Court observed that section 14A is not applicable for deductions, which are permissible and allowed under Chapter VIA. Section 14A is applicable only if an income is not included in the total income as per the provisions of Chapter III of the Income- tax Act, 1961. Deductions under Chapter VIA are different from the exclusions/exemptions provided under Chapter III.

The words "do not form part of the total income under this Act" used in section 14A are significant and important. Income which qualifies for deductions under section 80C to 80U has to be first included in the total income of the assessee and then allowed as a deduction. However, income referred to in Chapter III do not form part of the total income and therefore, as per section 14A, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to such income which does not form part of the total income.

High Court's Decision: The Delhi High Court, therefore, held that no disallowance can be made under section 14A in respect of income included in total income in respect of which deduction is allowable under section 80C to 80U.

Note – The Department's Special Leave Petition against the above Delhi High Court judgement was dismissed on 15/2/2013.

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Illustration 1

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

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

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

Solution

HRA received	Rs.10,800
Less: Exempt under section 10(13A) [Working Note]	Rs. 7,680
Taxable HRA	**Rs. 3,120**

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

(a) the actual amount received (Rs.900 × 12) = Rs.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

= (Rs.1,000×12) - 10% of [(Rs.3,000+Rs.600) × 12] = Rs. 12,000 - Rs.4,320 = Rs.7,680

(c) 40% salary as his accommodation is situated at Kanpur

= 40% of [(Rs.3,000+ Rs.600) × 12] = Rs.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.

Illustration 2

Mr. Mohit is employed with XY Ltd. on a basic salary of Rs.10,000 p.m. He is also entitled to dearness allowance @ 100% of basic salary, 50% of which is included in salary as per terms of employment. The company gives him house rent allowance of Rs.6,000 p.m. which was increased to Rs.7,000 p.m. with effect from 1.01.2018. He also got an increment of Rs.1,000 p.m. in his basic salary with effect from 1.02.2018. Rent paid by him during the previous year 2017- 18 is as under:

April and May, 2017	-	Nil, as he stayed with his parents
June to October, 2017	-	Rs.6,000 p.m. for an accommodation in Ghaziabad
November, 2017 to March, 2018	-	Rs.8,000 p.m. for an accommodation in Delhi

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DT QUESTION BANK BY YNB

Compute his gross salary for assessment year 2018-19.

Solution:

Computation of gross salary of Mr. Mohit for A.Y. 2018-19

Particulars	Rs.
Basic salary [(Rs.10,000 × 10) + (Rs.11,000 × 2)]	1,22,000
Dearness Allowance (100% of basic salary)	1,22,000
House Rent Allowance (See Note below)	21,300
Gross Salary	**2,65,300**

Note: Computation of Taxable House Rent Allowance (HRA)

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Particulars	April-May (`)	June-Oct (`)	Nov-Dec (`)	Jan (`)	Feb-March (`)
Basic salary per month	10,000	10,000	10,000	10,000	11,000
Dearness allowance (included in salary as per terms of employment) (50% of basic salary)	5,000	5,000	5,000	5,000	5,500
Salary per month for the purpose of computation of house rent allowance	15,000	15,000	15,000	15,000	16,500
Relevant period (in months)	**2**	**5**	**2**	**1**	**2**
Salary for the relevant period (Salary per month × relevant period)	30,000	75,000	30,000	15,000	33,000
Rent paid for the relevant period	Nil	30,000 (`6,000×5)	16,000 (`8,000×2)	8,000 (`8,000×1)	16,000 (`8,000×2)
House rent allowance (HRA) received during the relevant period **(A)**	12,000 (`6,000×2)	30,000 (`6,000×5)	12,000 (`6,000×2)	7,000 (`7,000×1)	14,000 (`7,000×2)
Least of the following is exempt [u/s 10(13A)]					
1.Actual HRA received	12,000	30,000	12,000	7,000	14,000
2.Rent paid – 10% of salary	N.A.	22,500	13,000	6,500	12,700

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3.40% of salary (Residence at Ghaziabad– June to Oct, 2017) 50% of salary (Residence at Delhi–Nov'17-March'18)	N.A.	30,000 (40% × ` 75,000)	15,000 (50% × `30,000)	7,500 (50% × `15,000)	16,500 (50% × `33,000)
Exempt HRA (B)	**Nil**	**22,500**	**12,000**	**6,500**	**12,700**
Taxable HRA (Actual HRA – Exempt HRA) **(A-B)**	12,000	7,500	Nil	500	1,300

Taxable HRA (total) = Rs.12,000 + Rs.7,500 + Rs.500 + Rs.1,300 = Rs.21,300

Illustration 3

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

Transport allowance : Rs.1,800 p.m.

Tribal area allowance : Rs.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 [(Rs.150 – Rs.100) p.m. × 12 months] = Rs.600

Younger son [(Rs.70 – Rs.70) p.m. × 12 months] = Nil Rs.600

Transport allowance [(Rs.1,800 – Rs.1,600) p.m. × 12 months] Rs.2,400

Tribal area allowance [(Rs.500 – Rs.200) p.m. × 12 months] Rs.3,600

∴ Taxable allowances Rs.6,600

Illustration 4

Ayush, an employee of a management consultancy firm, was sent to UK in connection with a project of the firm's client for two months in the previous year. In addition to his salary, the firm

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paid per diem allowance for the period when he worked in UK to meet expenses on boarding and lodging. Tax was not deducted at source from such allowance by the employer. Ayush did not include such allowance in computation of his taxable salary for the relevant assessment year. In course of assessment of Ayush under section 143(3), the Assessing Officer sent a notice to him asking him to explain why the per diem allowance received by him should not be charged to tax? Ayush has sought your advice.

Solution

Per-diem allowance is exempt from tax under section 10(14)(i) read with Rule 2BB, as it is an allowance granted and spent to meet the ordinary daily charges incurred by an employee on account of absence from his normal place of duty. Rule 2BB exempts the allowance granted to meet the ordinary daily charges incurred by an employee on account of his absence from his normal place of duty.

In the given case, Mr. Ayush was posted for a period of 2 months outside his normal place of duty and the allowance was paid to meet the boarding and lodging.

Therefore, the allowance would fall under section 10(14)(i) read with Rule 2BB and would hence be exempt, assuming that expenditure to that extent was actually incurred for his boarding and lodging.

(C) Allowances which are fully exempt

Illustration 5

Mr. Sagar retired on 1.10.2017 receiving Rs.5,000 p.m. as pension. On 1.2.2018, he commuted 60% of his pension and received Rs.3,00,000 as commuted pension. You are required to compute his taxable pension assuming:

(a) He is a government employee.

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

(c) He is a non-government employee and is not in receipt of 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)	` 3,00,000	**NIL**
Taxable pension		**` 24,000**

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(b) He is a non-government employee, receiving gratuity Rs.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) $\left(\frac{1}{3} \times ` 3,00,000 \times \frac{100}{60}\right)$	` 1,66,667	` 1,33,333
Taxable pension		**` 1,57,333**

(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	
Less: Exempt u/s 10(10A) $\left(\frac{1}{2} \times ` 3,00,000 \times \frac{100}{60}\right)$	`2,50,000	` 50,000
Taxable pension		**`74,000**

Illustration 6

Mr. Ravi retired on 15.6.2017 after completion of 26 years 8 months of service and received gratuity of Rs.6,00,000. At the time of retirement, his salary was:

Basic Salary : Rs.5,000 p.m.

Dearness Allowance : Rs.3,000 p.m. (60% of which is for retirement benefits)

Commission : 1% of turnover (turnover in the last 12 months was Rs.12,00,000)

Bonus : Rs.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 the Payment of Gratuity Act 1972.

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(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	Rs.6,00,000
Less: Exemption under section 10(10) (Note)	Rs.1,24,615
Taxable Gratuity	Rs.4,75,385

Note: Least of the following would be exempt under section 10(10):

(i)	Gratuity received	Rs.6,00,000
(ii)	Statutory limit	Rs.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	

$$\frac{15}{26} \times \text{last drawn salary} \times \text{years of service}$$

$$\frac{15}{27} \times (\text{Rs.}5,000 + \text{Rs.}3,000) \times \frac{27}{26} =$$

Rs.1,24,615

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

Gratuity received at the time of retirement	Rs.6,00,000
Less: Exemption under section 10(10) (Note)	Rs.1,01,400
Taxable Gratuity	Rs.4,98,600

Note: Exemption under section 10(10) would be least of the following:

(i) Gratuity received Rs.6,00,000

(ii) Statutory limit Rs.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.

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

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

= Rs.1,01,400

(c) He is a government employee

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Gratuity received at the time of retirement	Rs.6,00,000
Less : Exemption under section 10(10)	Rs.6,00,000
Taxable gratuity	**Nil**

Illustration 7

Mr. G

upta retired on 1.12.2017 after 20 years 10 months of service, receiving leave salary of Rs.5,00,000. Other details of his salary income are:

Basic Salary	: Rs.5,000 p.m. (Rs.1,000 was increased w.e.f. 1.4.2017)
Dearness Allowance	: Rs.3,000 p.m. (60% of which is for retirement benefits)
Commission	: Rs.500 p.m.
Bonus	: Rs.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	Rs.5,00,000
Less: Exemption under section 10(10AA)	Rs.5,00,000
Taxable Leave salary	**Nil**

(b) He is a non-government employee

Leave Salary received at the time of retirement	Rs.5,00,00
0 Less: Exempt under section 10(10AA) [See Note below]	Rs.26,400
Taxable Leave Salary	**Rs.4,73,60**
0	

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

(i) Leave salary received	Rs.5,00,000
(ii) Statutory limit	Rs.3,00,000

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(iii) 10 months' salary based on average salary of last 10 months

$$\text{i.e.} \left[10 \times \frac{\text{Salary of last 10 months i.e. Feb - Nov}}{\text{10 months}} \right]$$

$$= \left[10 \times \frac{(5000 \times 8) + (4000 \times 2) + (60\% \times 3000 \times 10)}{\text{10 months}} \right] \quad \text{Rs. } 66,000$$

(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)

Leave Due = Leave allowed – Leave taken

= (30 days per year × 20 years) – 480 days

= 120 days

$$\text{i.e.} \left[\frac{\text{Leave due (in days)}}{\text{30 days}} \times \text{Average salary p.m.} \right]$$

$$= \left[\frac{\text{120 days}}{\text{30 days}} \times \frac{\text{Rs. } 66,000}{10} \right] \quad \text{Rs. } 26,400$$

Provident fund

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Illustration 8

Mr. A retires from service on December 31, 2017, after 25 years of service. Following are the particulars of his income/investments for the previous year 2017-18:

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 unrecognized provident fund, the employer's contribution was Rs. 2,20,000 and the interest thereon Rs. 50,000. The employee's contribution was Rs. 2,70,000 and the interest thereon Rs. 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 2018-19?

Solution

Taxable portion of the amount received from the URPF in the hands of Mr. A for the A.Y. 2018-19 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	50,000
Total	**2,70,000**
Amount taxable under the head "Income from Other Sources":	
Interest on the employee's share	60,000
Total amount taxable from the amount received from the fund	**3,30,000**

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 9

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.

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Illustration 10

Mr. B is working in XYZ Ltd. and has given the details of his income for the P.Y.2017-18. You are required to compute his gross salary from the details given below:

Basic Salary	Rs.10,000 p.m.
D.A. (50% is for retirement benefits)	Rs.8,000
p.m. Commission as a percentage of turnover	0.1%
Turnover during the year	Rs.50,00,000
Bonus	Rs.40,000
Gratuity	Rs.25,000
His own contribution in the RPF	Rs.20,000
Employer's contribution to RPF	20% of his basic salary
Interest accrued in the RPF @ 13% p.a.	Rs.13,000

Solution

Computation of Gross Salary of Mr. B for the A.Y.2018-19

Particulars	Rs.	Rs.
Basic Salary [Rs.10,000 × 12]		1,20,000
Dearness Allowance [Rs.8,000 × 12]		96,000
Commission on turnover [0.1% × Rs.50,00,000]		5,000
Bonus		40,000
Gratuity **[Note 1]**		25,000
Employee's contribution to RPF **[Note 2]**		-
Employers contribution to RPF [20% of Rs.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.

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i.e., 12% of [Basic Salary + Dearness Allowance forming part of retirement benefits + Commission based on turnover] = 12% of [Rs.1,20,000 + (50% × Rs.96,000) + Rs.5,000] = 12% of Rs.1,73,000 = Rs.20,760

(viii) 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

Illustration 11

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

Solution

Retrenchment compensation received	Rs.10,00,000
Less: Exemption under section10(10B) [See Note below]	Rs.4,32,692
Taxable retrenchment compensation	Rs.5,67,308

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

(i) Compensation actually received = Rs.10,00,000

(ii) Statutory Limit = Rs.5,00,000

(iii) Amount calculated in accordance with provisions of the Industrial Disputes Act, 1947

$$= \left\lceil \frac{15}{26} \times \frac{(20,000 \times 3) + (5,000 \times 3)}{3} \times 30 \text{ years} \right\rceil = \text{Rs.}4,32,692$$

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Illustration 12

Mr. Dutta received voluntary retirement compensation of Rs.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 Rs.20,000 p.m.; Dearness allowance (which forms part of pay) Rs.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	Rs.7,00,00
0 Less: Exemption under section 10(10C) [**See Note below**]	Rs.5,00,00
0 Taxable voluntary retirement compensation	Rs.2,00,00
0	

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

(i) Compensation actually received = Rs.7,00,000

(ii) Statutory limit = Rs.5,00,000

(iii) Last drawn salary × 3 × completed years of service

= (Rs.20,000 + Rs.5,000) × 3 × 30 years = Rs.22,50,000

(iv) Last drawn salary × remaining months of service

= (Rs.20,000 + Rs.5,000) × 6 × 12 months = Rs.18,00,000

Illustration 13

Mr. D went on a holiday on 25.12.2017 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 Rs.60,000 (Rs.45,000 for adults and Rs.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.

Illustration14

In the above illustration 13, will there be any difference if among his three children the twins

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were 5 years old and the son 3 years old? Examine.

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

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

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

(3) Perquisites taxable only in the hands of specified employees [Section 17(2)(iii)]

Illustration 15

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	Rs.6,000 p.m.
Dearness Allowance	Rs.2,000 p.m. (30% is for retirement benefits)
Bonus	Rs.1,500 p.m.

Even though the company allotted the house to him on 1.4.2017, he occupied the same only from 1.11.2017. Calculate the taxable value of the perquisite for A.Y.2018-19.

Solution

Value of the rent free unfurnished accommodation

= 15% of salary for the relevant period

= 15% of [(Rs.6000 × 5) + (Rs.2,000 × 30% × 5) + (Rs.1,500 × 5)] **[See Note below]**

= 15% of Rs.40,500 = Rs.6,075.

Note: Since, Mr. C occupies the house only from 1.11.2017, 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 1.11.2017 to 31.03.2018) will be considered.

Illustration 16

Using the data given in the previous illustration 15, compute the value of the perquisite if Mr. C is required to pay a rent of Rs.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 Rs.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 Rs.6,075 (i.e. 15% of Rs.40,500). The rent paid by the employee is Rs.5,000 (i.e., Rs.1,000 x 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	= Rs.6,075
Less: Rent paid by the employee (Rs.1,000 × 5)	= Rs.5,000
Perquisite value of unfurnished accommodation given at concessional rent	**= Rs. 1,075**

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Illustration 17

Using the data given in illustration 15, compute the value of the perquisite if ABC Ltd. has taken this accommodation on a lease rent of Rs.1,200 p.m. and Mr. C is required to pay a rent of Rs.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 Rs.6,075 (i.e. 15% of Rs.40,500). Rent paid by the employer is Rs.6,000 (i.e. Rs.1,200 x 5). The lower of the two is Rs.6,000, which exceeds the rent paid by the employee i.e. Rs.5,000 (Rs.1,000 x 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 **[Note]** = Rs.6,000

Less: Rent paid by the employee (Rs.1,000 × 5) = Rs.5,000

∴ Value of unfurnished accommodation given at concessional rent =

Rs.1,000 Note: Value of the rent free unfurnished accommodation is lower of

(i) Lease rent paid by the company for relevant period = Rs.1,200 × 5 = Rs.6,000

(ii) 15% of salary for the relevant period (computed earlier) = Rs.6,075

Illustration 18

Using the data given in illustration 15, compute the value of the perquisite if ABC Ltd. has provided a television (WDV Rs.10,000; Cost Rs.25,000) and two air conditioners. The rent paid by the company for the air conditioners is Rs.400 p.m. each. The television was provided on 1.1.2018. However, Mr. C is required to pay a rent of Rs.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 Rs.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 Rs.6,075 (i.e. 15% of Rs.40,500). The rent paid by the employee is Rs.5,000 (i.e. Rs.1,000 x 5). The value of furniture of Rs.4,625 (see Note below) is to be added to 15% of salary. The deemed concession in the matter of rent is Rs.6,075+ Rs.4,625 -

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Rs.5,000 =
Rs.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)	=	Rs.6,075
Add: Value of furniture provided by the employer **[Note]**	=	Rs.4,625
Value of rent free furnished accommodation	=	Rs.10,700
Less: Rent paid by the employee (Rs.1,000 × 5)	=	Rs.5,000
Value of furnished accommodation given at concessional rent	**=**	**Rs.5,700**

Note 1: Value of the furniture provided = (Rs.400 p.m. × 2 × 5 months) + (Rs.25,000 × 10% p.a. for 3 months) = Rs.4,000 + Rs.625 = Rs.4,625

Illustration 19

Using the data given in illustration 18 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 Rs.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 Rs.3,125 [i.e. Rs.3,500 (licence fees: Rs.700 x 5) + Rs.4,625 (Value of furniture) – Rs.5,000 (Rs.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 (Rs.700 × 5)	=
Rs.3,500 Add: Value of furniture provided by the employer (computed earlier)	=
Rs.4,625 Value of rent free furnished accommodation	=
Rs.8,125	
Less: Rent paid by the employee (Rs.1,000 × 5)	= Rs.5,000
Perquisite value of furnished accommodation given at concessional rent	= Rs.3,125

Illustration 20

Mr. X and Mr. Y are working for M/s. Gama Ltd. As per salary fixation norms, the following perquisites were offered:

(i) For Mr. X, who engaged a domestic servant for Rs.500 per month, his employer reimbursed the entire salary paid to the domestic servant i.e. Rs.500 per month.

(ii) For Mr. Y, he was provided with a domestic servant @ Rs.500 per month as part of remuneration package.

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You are required to comment on the taxability of the above in the hands of Mr. X and Mr. Y, who are not specified employees.

Solution:

In the case of Mr. X, it becomes an obligation which the employee would have discharged even if the employer did not reimburse the same. Hence, the perquisite will be covered under section 17(2)(iv) and will be taxable in the hands of Mr. X. This is taxable in the case of all employees.

In the case of Mr. Y, it cannot be considered as an obligation which the employee would meet. The employee might choose not to have a domestic servant. This is taxable only in the case of specified employees covered by section 17(2)(iii). Hence, there is no perquisite element in the hands of Mr. Y.

Illustration 21

Ranjit has taken an interest-free loan of Rs.10 lacs from his company. The amount is utilized by him for purchasing a house on 30-06-2016. The house is self-occupied. As per the scheme of the company, loan would be recovered in 40 equal monthly instalments recoverable immediately after the completion of 18th month from the date of purchase. Assuming the SBI lending rate of similar loan on 1.4.2017 was 9.75%. Calculate the perquisite value of such loan in the hands of Ranjit for the assessment year 2018-19. Is it possible to get deduction of perquisite value of interest under section 24(b)? Does it make any difference, if the house is given on rent?

Solution

First instalment will be due on 1st January, 2018. Amount of instalment will be:

Rs.10,00,000 ÷ 40 = Rs.25,000.

Therefore, value for perquisite for interest-free loan will be calculated by applying the interest rate charged by the State Bank of India on the first day of the relevant previous year, on the outstanding amount of loan as reduced by the interest, if any, actually paid by the employee. Therefore, the value of perquisite will be as follows:

		`
From April 17 to Dec. 17	(10,00,000 x 9.75% x 9/12)	73,125
For the month of Jan. 18	(9,75,000 x 9.75% x 1/12)	7,922
For the month of Feb. 18	(9,50,000 x 9.75% x 1/12)	7,719
For the month of Mar. 18	(9,25,000 x 9.75% x 1/12)	7,516
	Total	**96,282**

Therefore, the perquisite value of interest-free loan will be Rs.96,282.

Interest on capital borrowed for the purchase, construction, re-construction, repair or renewals of house property is deductible under section 24(b). In this case, capital is borrowed from the employer without interest. There is no interest paid or payable in respect of the amount of loan of Rs.10 lacs. Consequently, no deduction under section 24(b) would be available, whether the house is self-occupied or let out.

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Illustration 22

Find out the taxable value of perquisite from the following particulars in case of an employee to whom the following assets held by the company were sold on 13.6.2017:

	Car	*Laptop*	*Furniture*
Cost of Purchase (May 2015) (`)	*8,72,000*	*1,22,500*	*35,000*
Sale Price (`)	*5,15,000*	*25,000*	*10,000*

The assets were put to use by the company from the day these were purchased.

Solution

The assets transferred by the company shall be considered for the purpose of valuation of perquisites under section 17(2) of the Act read with Rules. The value of perquisite in respect of assets transferred is determined after allowing normal wear & tear for the period of use of such assets by employer.

	Car	*Laptop*	*Furniture*
Rate of Depreciation	20%	50%	10%
Basis of Depreciation	WDV	WDV	SLM
Cost of asset to company – May 2015	8,72,000	1,22,500	35,000
Less: Normal wear & tear upto May, 2016	1,74,400	61,250	3,500
	6,97,600	61,250	31,500
Less: Normal wear and tear upto May, 2017	1,39,520	30,625	3,500
Balance, in May, 2017	5,58,080	30,625	28,000
Less: Sale value on 13.06.2017	5,15,000	25,000	10,000
Value of Perquisite	**43,080**	**5,625**	**18,000**

Note: As per Rule 3(7) of Income-tax Rules, 1962 normal wear and tear has to be calculated at the aforementioned prescribed rates applying Straight Line Method (SLM) to Furniture and Written Down Value (WDV) method to all other assets.

Illustration 23

X Ltd. provided the following perquisites to its employee Mr. Y for the P.Y.2017-18 –

(1) Accommodation taken on lease by X Ltd. for Rs.15,000 p.m. Rs.5,000 p.m. is recovered from the salary of Mr. Y.

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(2) Furniture, for which the hire charges paid by X Ltd. is Rs.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 Rs.10,000 on his birthday.

Compute the value of perquisites chargeable to tax for the A.Y.2018-19, assuming his salary for perquisite valuation to be Rs.10 lakh.

Solution

Computation of the value of perquisites chargeable to tax in the hands of Mr. Y for the A.Y.2018-19

	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 (` 3,000 × 12)		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 [(` 1,800 + ` 900) × 12]			32,400
(3)	Value of gift voucher			10,000
	Value of perquisites chargeable to tax			**1,68,400**

Illustration 24

Compute the taxable value of the perquisite in respect of medical facilities received by Mr. G from his employer during the P.Y.2017-18:

Medical premium paid for insuring health of Mr. G	Rs.7,000
Treatment of Mr. G by his family doctor	Rs.5,000
Treatment of Mrs. G in a Government hospital	Rs.25,000

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DT QUESTION BANK BY YNB

Treatment of Mr. G's grandfather in a private clinic Rs.12,000

Treatment of Mr. G's mother (68 years and dependant) by family doctor Rs.8,000

Treatment of Mr. G's sister (dependant) in a nursing home Rs.3,000

Treatment of Mr. G's brother (independent) Rs.6,000

Treatment of Mr. G's father (75 years and dependant) abroad Rs.50,000

Expenses of staying abroad of the patient and Rs.30,000

Limit specified by RBI Rs.75,000

Solution

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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**

Illustration 25

Mr. Goyal receives the following emoluments during the previous year ending 31.03.2018.

Basic pay Rs.40,000

Dearness Allowance Rs.15,000

Commission Rs.10,000

Entertainment allowance Rs.4,000

Medical expenses reimbursed

Rs.25,000 Professional tax paid

Rs.3,000 (Rs.2,000 was paid by his employer)

Mr. Goyal contributes Rs.5,000 towards recognized provident fund. He has no other income. Determine the income from salary for A.Y. 2018-19, if Mr. Goyal is a State Government employee.

Solution

Computation of salary of Mr. Goyal for the A.Y.2018-19

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DT QUESTION BANK BY YNB

Particulars	Rs.	Rs.
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 × ` 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 u/s 80C.

Illustration 26

In the case of Mr. Hari, who turned 65 years on 28.3.2018, you are informed that the salary for the previous year 2017-18 is Rs.10,20,000 and arrears of salary received is Rs.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:

Previous Year	*Taxable Salary*	*Arrears now received (`)*
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. 2018-19.

Note: **Rates of Taxes:**

Assessment	Slab rates of income-tax

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Year	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 Rs.2,40,000	Nil	Upto Rs.1,60,000	Nil
	Rs.2,40,000 - Rs.5,00,000	10%	Rs.1,60,000 - Rs.5,00,000	10%
	Rs.5,00,000 - Rs.8,00,000	20%	Rs.5,00,000 - Rs.8,00,000	20%
	Above Rs.8,00,000	30%	Above Rs.8,00,000	30%
2012–13	Upto Rs.2,50,000	Nil	Upto Rs.1,80,000	Nil
	Rs.2,50,000 - Rs.5,00,000	10%	Rs.1,80,000 - Rs.5,00,000	10%
	Rs.5,00,000 - Rs.8,00,000	20%	Rs.5,00,000 - Rs.8,00,000	20%
	Above Rs.8,00,000	30%	Above Rs.8,00,000	30%
2013–14	Upto Rs.2,50,000	Nil	Upto Rs.2,00,000	Nil
	Rs.2,50,000 - Rs.5,00,000	10%	Rs.2,00,000 - Rs.5,00,000	10%
	Rs.5,00,000 - Rs.10,00,000	20%	Rs.5,00,000 - Rs.10,00,000	20%
	Above Rs.10,00,000	30%	Above Rs.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.2018-19

Particulars	Incl. arrears of salary	Excl. arrears of salary
	`	`
Current year salary	10,20,000	10,20,000
Add: Arrears of salary	3,45,000	
Taxable Salary	13,65,000	10,20,000
Income-tax thereon	2,19,500	1,16,000
Add: Education cess @2% plus SHEC@1%	6,585	3,480
Total payable	**2,26,085**	**1,19,480**

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Computation of tax payable on arrears of salary if charged to tax in the respective AYs

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	1,03,000	--	1,17,000	---	1,25,000	---
Taxable salary	**8,13,000**	**7,10,000**	**9,42,000**	**8,25,000**	**10,75,000**	**9,50,000**
Tax on the above	97,900	76,000	1,34,600	99,500	1,47,500	1,15,000
Add: Cess@3%	2,937	2,280	4,038	2,985	4,425	3,450
Tax payable	**1,00,837**	**78,280**	**1,38,638**	**1,02,485**	**1,51,925**	**1,18,450**

Computation of relief under section 89

	Particulars	`	`
(i)	Tax payable in A.Y.2018-19 on arrears:		
	Tax on income including arrears	2,26,085	
	Less : Tax on income excluding arrears	1,19,480	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)	2,99,215	92,185
	Relief under section 89 - difference between tax on arrears in A.Y 2018-19 and tax on arrears in the respective years		**14,420**

Tax payable for A.Y.2018-19 after relief under section 89

Particulars	`
Income-tax payable on total income including arrears of salary	2,26,085
Less : Relief under section 89 as computed above	14,420
Tax payable after claiming relief	**2,11,665**

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EXERCISE

Question 1

Examine the correctness or otherwise of the following case in the context of provisions contained in the Income-tax Act, 1961 relevant/applicable for the assessment year 2018-19:

(i) Nargis, working as Regional Area Sales Manager of Pincer Marketing Ltd., was paid salary and a commission based as a percentage on the volume of sales effected by her. Nargis claimed the expenses incurred by her for earning the commission in the return of income, which were disallowed by the Assessing Officer.

(ii) An amount of Rs. 12,50,000 paid by XYZ Ltd., after approval by the board, to a hospital in UK for the heart surgery of its managing director was charged under medical expenses. The Assessing Officer, while completing the assessment of the company, taxed the amount so paid by the company as a perquisite in the hands of its Managing Director.

Answer

(i) The facts of this case are similar to the case decided by the Madras High Court in CIT v. R. Rajendran (2003) 260 ITR 0476, where it was held that since the assessee was employed as a regional sales manager and the commission paid to him is based on the volume of sales effected, such commission was obviously paid to the employee as an encouragement to effect a higher level of sales. The commission paid in addition to what the employee was getting as a fixed salary would also constitute/form part of salary. When the commission is chargeable as salary, then no deduction is allowable in respect of any expenditure incurred to earn the commission.

Therefore, in this case, the claim made by Nargis is not valid and the expenses incurred for earning commission are not allowable as deduction while computing her salary income.

(ii) A Managing Director generally occupies the dual capacity of being a director as well as an employee of the company. In this case, assuming that the Managing Director is also an employee of XYZ Ltd., clause (vi) of the proviso to section 17(2) would get attracted. Clause (vi) of the proviso to section 17(2) provides that any expenditure incurred by the employer on medical treatment of the employee outside India shall be excluded from perquisite only to the extent permitted by RBI. Therefore, the expenditure on medical treatment of the Managing Director outside India shall be excluded from perquisite to the extent permitted by RBI as per clause (vi) of the proviso to section 17(2). If it is assumed that the entire amount is permitted by RBI, there would be no perquisite chargeable in the hands of the Managing Director. Therefore, in such a case, the action of the Assessing Officer in taxing the entire amount paid by the company as a perquisite in the hands of the Managing Director is incorrect.

This question can also be answered by applying the rationale of the Allahabad High Court ruling in CIT v. D.P. Kanodia (2008) 296 ITR 0616. In that case, the High Court observed that the reimbursement by the company of medical expenditure incurred outside India by the director cannot be considered as an amenity or benefit provided by the company to its director, and therefore the provisions of section 17(2)(iii)(a) would not be attracted. Therefore, such reimbursement was not a perquisite within the meaning of section 17(2)(iii)(a).

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Hence, applying the rationale of the above case to the facts of this case, the action of the Assessing Officer in taxing the amount paid by the company as a perquisite in the hands of the Managing Director is incorrect.

Question 2

Mr. X is a Member of Legislative Assembly. He underwent an open heart surgery abroad in respect of which he received Rs.5 Lacs from the State Government towards reimbursement of his medical expenses. The Assessing Officer contended that such amount is taxable as a perquisite under section 17. Discuss the correctness of the contention of the Assessing Officer.

Answer

The facts of this case are similar to the facts in CIT v. Shiv Charan Mathur (2008) 306 ITR 126 (Raj.). In the instant case, the High Court observed that MPs and MLAs do not fall within the meaning of "employees". They are elected by the public, their election constituencies and it is consequent upon such election that they acquire constitutional position and are in charge of constitutional functions and obligations. The remuneration received by them, after swearing in, cannot be said to be salary within the meaning of section 15, since the basic ingredient of employer-employee relationship is missing in such cases.

Therefore, the remuneration received by MPs and MLAs is taxable under the head "Income from Other Sources" and not under the head "Salaries". When the provisions of section 15 are not attracted to the remuneration received by MPs and MLAs, the provisions of section 17 also would not apply as section 17 only extends the definition of salary by providing that certain items mentioned therein would be included in salary as "perquisites". Thus, reimbursement of medical expenditure (incurred for open heart surgery abroad) to an MLA cannot be taxed as a perquisite under section 17.

Applying the above ruling to the case on hand, the contention of the Assessing Officer is not correct.

Question 3

Mr. Kadam is entitled to a salary of Rs.25,000 per month. He is given an option by his employer either to take house rent allowance or a rent free accommodation which is owned by the company. The HRA amount payable was Rs.5,000 per month. The rent for the hired accommodation was Rs. 6,000 per month at New Delhi. Advice Mr. Kadam whether it would be beneficial for him to avail HRA or Rent Free Accommodation. Give your advice on the basis of "Net Take Home Cash benefits".

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Answer

Computation of tax liability of Kadam under both the options

Particulars			Option I – HRA (`)	Option II – RFA (`)
Basic Salary (` 25,000 x 12 Months)			3,00,000	3,00,000
Perquisite value of rent-free accommodation (15% of ` 3,00,000)			N.A.	45,000
House rent Allowance (` 5,000 x 12 Months)		` 60,000		
Less: Exempt u/s 10(13A) – least of the following -				
- 50% of Basic Salary		` 1,50,000		
- Actual HRA		` 60,000		
- Rent less 10% of salary	` 42,000	` 42,000	18,000	
Income taxable under the head "Salaries"			3,18,000	3,45,000
Less: Deduction under Chapter VI-A			-	-
Total Income			**3,18,000**	**3,45,000**
Tax on total income			3,400	4,750
Less: Rebate u/s 87A (Since total income is less than ` 3,50,000) would be lower of ` 2,500 or the tax liability, whichever is lower			2,500	2,500
			900	2,250
Add: Education cess@1% and SHEC @ 2%			27	68
Total tax payable			**927**	**2,318**

Cash Flow Statement

Particulars	Option I – HRA	Option II – RFA
Inflow: Salary	3,60,000	3,00,000
Less: Outflow: Rent paid	(72,000)	-

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Tax on total income	(927)	(2,318)
Net Inflow	**2,87,073**	**2,97,682**

Since the net cash inflow under option II (RFA) is higher than in Option I (HRA), it is beneficial for Mr. Kadam to avail Option II, i.e., Rent free accommodation.

Question 4

Mr. M is working with MNO Limited for the last 10 years. He was granted an option on 1.7.2015 by the company to purchase 800 equity shares at a price of Rs.250 per share. The period during which the option can be exercised to purchase 800 shares at a pre-determined price of Rs.250 per share commencing on 1.7.2015 and ending on 31.3.2018. Mr. M exercised the option on 15.3.2017 to purchase 500 shares. Fair market value on the said date was Rs.6490 on the Bombay Stock Exchange and Rs.6500 on the National Stock Exchange. The NSE has recorded the higher volume of trading in that share.

The company has allotted him 500 shares on 24th April, 2017. The fair market value on the date of allotment was Rs.7100 per share on NSE and Rs.7110 on the BSE that has recorded the higher volume of trading in that share. The option was granted for making available rights in the nature of intellectual property rights.

Determine the taxability of perquisite. Does it make any difference if the option was granted for providing technical know-how?

Answer

The perquisite of sweat equity shares shall be taxable in the previous year 2017-18 (assessment year 2018-19), being the previous year of allotment of such shares. The value of sweat equity shares shall be the fair market value of such 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 shares.

As per Rule 3(8) of the Income-tax Rules, 1962, the fair market value of a share on the date of exercising the option shall be the price of the share on the recognized stock exchange which records the highest volume of trading in such shares, in case the shares are listed on more than one recognised stock exchange.

Hence, the value of taxable perquisite for sweat equity shares

= FMV on the date of exercising the option on the NSE (since it recorded higher volume that BSE) (-) Amount recovered from the employee

= (500 × Rs.6500) - (500 × Rs.250)

= Rs.32,50,000 - Rs.1,25,000 = Rs.31,25,000

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As per section 17(2)(vi), "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 technical knowhow or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

Therefore, this provision is equally applicable whether the sweat equity shares option was granted for making available rights in the nature of intellectual property rights or for providing technical know- how.

Question 5

Ajay is employed as senior executive of Manu Ltd. Manu Ltd offers rights to its existing shareholders in the ratio 1:1 on 15th February 2018 at Rs.150 per share. Ajay was offered 500 shares at Rs.150, which he exercised. On these facts, you are consulted by Ajay as to:

(a) The tax consequences for the assessment year 2018-19 assuming that fair market value on the date of exercise of option is Rs.300.

(b) If Ajay is already a shareholder of 250 shares, allotted in public issue will it make any difference?

Answer

(a) As per section 17(2)(vi), 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 employee is taxable as perquisite. The meaning of the terms 'specified security', 'sweat equity shares', 'fair market value' are dealt with in the Explanation given therein.

The fair market value of the shares so determined in accordance with the method as may be prescribed less the amount actually recovered from the employee, shall be the value of perquisite chargeable to tax.

The value of perquisite would be:

	`
Fair market value of shares determined as per the prescribed method in Income-tax Rules, 1962 = 500 shares @ ` 300 each	1,50,000
Less: Amount recovered from the employee @ ` 150 per share	75,000
Value of perquisite chargeable to tax	**75,000**

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As per section 49(2AA), the cost of acquisition of specified security or sweat equity shares referred to in section 17(2)(vi) shall be the fair market value which has been taken into account for the purpose of perquisite valuation.

(b) In case the employee is a shareholder and was allotted shares in the same manner as was allotted to other shareholders by the company without any concession / reduction in value then the question of valuation of perquisite would not arise.

SIGNIFICANT SELECT CASES

1. Can notional interest on security deposit given to the landlord in respect of residential premises taken on rent by the employer and provided to the employee, be included in the perquisite value of rent-free accommodation given to the employee?

CIT v. Shankar Krishnan (2012) 349 ITR 0685 (Bom.)

Facts of the case: The assessee, a salaried employee, was provided with rent-free accommodation, being a flat in Mumbai, by his employer company. The monthly rent paid by the employer in respect of the said flat was Rs.10,000 per month. The employer had given an interest-free refundable security deposit of Rs.30 lacs to the landlord for renting out the said premises. The assessee-employee computed the perquisite value on the basis of rent of Rs.10,000 paid by his employer to the landlord, since the same was lower than 10% **(now, 15%)** of salary.

Assessing Officer's contention: The Assessing Officer, however, contended that since the employer had given interest-free deposit of Rs.30,00,000 to the landlord, interest @12% on the said deposit is required to be taken into consideration for estimating the fair rental value of the flat given to the assessee and accordingly, he enhanced the perquisite value of the residential accommodation provided to the employee by such notional interest. The Commissioner (Appeals) upheld the decision of the Assessing Officer.

Tribunal's Observations: The Tribunal observed that, as per Rule 3 of the Income-tax Rules, 1962, the perquisite value of the residential accommodation provided by the employer shall be the **actual** amount of lease rent paid or payable by the employer or 10% (now, 15%) of salary, whichever is lower, as reduced by the rent, if any, actually paid by the employee. The Tribunal, therefore, held that there is no concept of determination of the fair rental value for the purpose of ascertaining the perquisite value of the rent-free accommodation provided to the employees.

High Court's Decision: On appeal by the Revenue, the Bombay High Court held that the Assessing Officer is not right in adding the notional interest on the security deposit given by the employer to the landlord in valuing the perquisite of rent-free accomodation, since the perquisite value has to be computed as per Rule 3 and Rule 3 does not require addition of such notional interest. Thus, the perquisite value of the residential accommodation provided by the employer would be the actual amount of lease rental paid or payable by the employer, since the same was lower than 10% (now 15%) of salary.

2. Can the limit of Rs.1,000 per month per child be allowed as standard deduction, while

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computing the perquisite value of free or concessional education facility provided to the employee by the employer?

CIT (TDS) v. Director, Delhi Public School (2011) 202 Taxman 318 (Punj. & Har.)

As per the provisions of Rule 3(5) of the Income-tax Rules, 1962, in case an educational institution is maintained and owned by the employer and free or concessional education facility is provided to the employees' household in such institution, then, the cost of education in a similar institution in or near the locality shall be taken to be the value of perquisite in the hands of the employee. In case the cost of such education or the value of benefit does not exceed Rs.1,000 per month per child, the perquisite value shall be taken to be Nil.

Assessee's contention: In the present case, the cost of education was more than Rs.1,000 per month per child, therefore, while determining the perquisite value on the above basis, the assessee claimed a deduction of Rs.1,000 per month per child.

High Court's Decision: The Punjab and Haryana High Court, in the above case, held that on a plain reading of Rule 3(5), it flows that, in case the value of perquisite for free/concessional educational facility arising to an employee **exceeds ` 1,000 per month per child, the whole perquisite shall be taxable in the hands of the employee and no standard deduction of ` 1,000 per month per child can be provided from the same.** It is only in case the perquisite value is less than ` 1,000 per month per child, the perquisite value shall be nil. Therefore, ` 1,000 per month per child is not a standard deduction to be provided while calculating such a perquisite.

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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*	*80,000*
Fair Rent	*90,000*	*60,000*	*65,000*	*25,000*	*75,000*
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

As per section 23(1), Gross Annual Value (GAV) is the higher of Expected rent and actual rent received. Expected rent is higher of municipal value and fair rent but restricted to standard rent.

Computation of GAV of each house owned by Jayashree

	Particulars	House I (`)	House II (`)	House III (`)	House IV (`)	House V (`)
(i)	Municipal value	*80,000*	*55,000*	*65,000*	*24,000*	*80,000*
(ii)	Fair rent	*90,000*	*60,000*	*65,000*	*25,000*	*75,000*
(iii)	**Higher of (i) & (ii)**	*90,000*	*60,000*	*65,000*	*25,000*	*80,000*
(iv)	Standard rent	*N.A.*	*75,000*	*58,000*	*N.A.*	*78,000*
(v)	**Expected rent [Lower of (iii) & (iv)**	*90,000*	*60,000*	*58,000*	*25,000*	*78,000*
(vi)	Actual rent received/ receivable	*72,000*	*72,000*	*60,000*	*30,000*	*72,000*
	GAV [Higher of (v) & (vi)]	**90,000**	**72,000**	**60,000**	**30,000**	**78,000**

Illustration 2

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Rajesh, a British national, is a resident and ordinarily resident in India during the P.Y.2017-18. 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.2017-18. The value of one £ in Indian rupee to be taken at Rs.82.50. Compute Rajesh's Net Annual Value of the property for the A.Y. 2018-19.

Solution

For the P.Y.2017-18, 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 be to allowed as deduction from the gross annual value.

Computation of Net Annual Value of the property of Mr. Rajesh for A.Y.2018-19

Particulars	`
Gross Annual Value (£ 10,000 □ 12 □ Rs.82.50)	99,00,000
Less: Municipal taxes paid (£ 8,000 □ Rs.82.50)	6,60,000
Net Annual Value (NAV)	**92,40,000**

Illustration 3

Arvind had taken a loan of Rs.5,00,000 for construction of property on 1.10.2016. Interest was payable @10% p.a. The construction was completed on 30.6.2017. No principal repayment has been made up to 31.3.2018. Compute the interest allowable as deduction under section 24 for the A.Y.2018-19.

Solution

Interest for the year (1.4.2017 to 31.3.2018) = 10% of Rs.5,00,000 = Rs.50,000

Pre-construction interest =10% of Rs.5,00,000 for 6 months (from 1.10.2016 to 31.3.2017) = Rs.25,000

Pre-construction interest to be allowed in 5 equal annual installments of Rs.5,000 from the year of completion of construction i.e. in this case, P.Y. 2017-18.

Therefore, total interest deduction under section 24 = Rs.50,000 + Rs.5000 = Rs.55,000.

Illustration 4

P, an individual, borrowed Rs.20,00,000 for repair of his self-occupied house property and paid interest of Rs.1,60,000 thereon during the financial year 2017-18. What is the amount of interest allowable as deduction under section 24 for the assessment year 2018-19?

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Solution

Section 24(b) provides that where the self-occupied house property has been acquired, constructed, repaired, renewed or reconstructed with borrowed capital, deduction towards interest payable thereon shall not exceed Rs.30,000. Therefore, only Rs.30,000 would be allowed as deduction on account of interest on loan borrowed for repair and reconstruction of self-occupied house property.

The higher limit of Rs.2,00,000 in respect of interest on loan borrowed on or after 1.4.1999 would be available only where such loan is borrowed for acquisition or construction of self-occupied property and not for repair of such property.

Illustration 5

Anirudh has a property whose municipal valuation is Rs. 1,30,000 p.a. The fair rent is Rs.1,10,000 p.a. and the standard rent fixed by the Rent Control Act is Rs.1,20,000 p.a. The property was let out for a rent of Rs.11,000 p.m. throughout the previous year. Unrealised rent was Rs.11,000 and all conditions prescribed by Rule 4 are satisfied. He paid municipal taxes @10% of municipal valuation. Interest on borrowed capital was Rs.40,000 for the year. Compute the income from house property of Anirudh for A.Y. 2018-19.

Solution

Computation of Income from house property of Mr. Anirudh for A.Y. 2018-19

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Particulars		Amount in `	
Computation of GAV			
Step 1	Compute ER		
	ER = 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 ER of ` 1,20,000 and Actual rent received/receivable of ` 1,21,000.		
Step 4	GAV is the higher of ER 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**

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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**

(2) LET OUT PROPERTY VACANT FOR PART OF THE YEAR

Particulars			Amount
Computation of GAV			
Step 1	Compute ER		
	ER = 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 ER and Actual rent received/receivable computed for the let-out period		
Step 4	If Actual rent is lower than ER owing to vacancy, then Actual rent is the GAV. If Actual rent is lower than ER due to other reasons, then ER is the GAV. However, in spite of vacancy, if the actual rent is higher than the ER, 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

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Illustration 6

Ganesh has a property whose municipal valuation is Rs.2,50,000 p.a. The fair rent is Rs.2,00,000 p.a. and the standard rent fixed by the Rent Control Act is Rs.2,10,000 p.a. The property was let out for a rent of Rs.20,000 p.m. However, the tenant vacated the property on 31.1.2018. Unrealised rent was Rs.20,000 and all conditions prescribed by Rule 4 are satisfied. He paid municipal taxes @8% of municipal valuation. Interest on borrowed capital wasRs. 65,000 for the year. Compute the income from house property of Ganesh for A.Y.2018-19.

Solution

Computation of income from house property of Ganesh for A.Y. 2018-19

Particulars	Amount in `	
Computation of GAV		
Step 1 Compute ER		
ER = Higher of MV of Rs.2,50,000 p.a. and FR of Rs.2,00,000 p.a., but restricted to SR of Rs.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 = Rs.2,00,000 - Rs.20,000	1,80,000	
Step 3 Compare ER and Actual rent received/receivable		
Step 4 In this case the actual rent of Rs.1,80,000 is lower than ER of Rs.2,10,000 owing to vacancy, since, had the property not been vacant the actual rent would have been Rs.2,20,000 (Rs.1,80,000 + Rs. 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 Rs.2,50,000		20,000
Net Annual Value (NAV)		**1,60,000**
Less: Deductions under section 24		
(a) 30% of NAV = 30% of Rs.1,60,000	48,000	

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(b) Interest on borrowed capital (actual without any ceiling limit)	65,000	1,13,000
Income from house property		**47,000**

Illustration 7

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 Rs.25,000 p.m. The municipal valuation is Rs.23,000 p.m. Municipal taxes paid is Rs.8,000. The house construction began in February 2011 with a loan of Rs.20,00,000 taken from SBI Housing Finance Ltd. The construction was completed on 30.11.2013. The accumulated interest up to 31.3.2013 isRs.1,50,000. During the previous year 2017-18, Poorna paid Rs.2,40,000 which includedRs.1,80,000 as interest. Compute Poorna's income from house property for A.Y. 2018-19.

Solution

Computation of income from house property of Smt. Poorna for A.Y.2018-19

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 the prescribed time - interest paid or payable subject to a maximum of ` 2,00,000 (including apportioned pre-construction interest) will be allowed as deduction. In this case the total interest is ` 1,80,000 + ` 30,000 (Being 1/5th of ` 1,50,000) = ` 2,10,000. However, the interest deduction is restricted to ` 2,00,000.	2,00,000
Loss from house property		**(2,00,000)**

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Illustration 8

Smt. Rajalakshmi owns a house property at Adyar in Chennai. The municipal value of the property is Rs.5,00,000, fair rent is Rs.4,20,000 and standard rent is Rs.4,80,000. The property was let-out for Rs.50,000 p.m. up to December 2017. Thereafter, the tenant vacated the property and Smt. Rajalakshmi used the house for self-occupation. Rent for the months of November and December 2017 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 Rs.25,000 during the year for amount borrowed for repairs for the house property. Compute her income from house property for the A.Y. 2018-19.

Solution

Computation of income from house property of Smt. Rajalakshmi for the A.Y.2018-19

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Particulars		Amount in `	
Computation of GAV			
Step 1	Compute ER for the whole year		
	ER = 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 ER 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 ER 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**

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Less:	**Deductions under section 24**		
	(a) 30% of NAV = 30% of Rs.4,20,000	1,26,000	
	(b) Interest on borrowed capital	25,000	1,51,000
Income from house property			**2,69,000**

Illustration 9

Ganesh has two houses, both of which are self-occupied. The particulars of the houses for the

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*

P.Y.2017-18 are as under:

Compute Ganesh's income from house property for A.Y.2018-19 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.2018-19

Let us first calculate the income from each house property assuming that they are deemed to be let out.

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Particulars	Amount in `	
	House I	House II
Gross Annual Value (GAV) ER is the GAV of house property ER = 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	NIL	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**

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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 Rs.24,600 for the A.Y. 2018-19.

(6) HOUSE PROPERTY, A PORTION LET OUT AND A PORTION SELF-OCCUPIED

Illustration 10

Prem owns a house in Madras. During the previous year 2017-18, 2/3rd portion of the house was self-occupied and 1/3rd portion was let out for residential purposes at a rent of Rs. 8,000 p.m. Municipal value of the property is Rs.3,00,000 p.a., fair rent is Rs.2,70,000 p.a. and standard rent is Rs.3,30,000 p.a. He paid municipal taxes @10% of municipal value during the year. A loan of Rs.25,00,000 was taken by him during the year 2013 for acquiring the property. Interest on loan paid during the previous year 2017-18 was Rs.1,20,000. Compute Prem's income from house property for the A.Y.2018-19.

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.2018-19

Particulars	Amount in `	
Unit I (2/3rd area – self-occupied)		
Annual Value		Nil
Less: Deduction under section 24(b) 2/3rd of ` 1,20,000		80,000
Income from Unit I (self-occupied)		**(80,000)**

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Unit II (1/3rd area – let out)			
Computation of GAV			
Step I	Compute ER		
	ER = Higher of MV and FR, restricted to SR However, in this case, SR of ` 1,10,000 (1/3rd of ` 3,30,000) is more than the higher of MV of ` 1,00,000 (1/3rd of ` 3,00,000) and FR of ` 90,000 (1/3rd of ` 2,70,000). Hence the higher of MV and FR is the ER. 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	Compare ER and Actual rent received/receivable		
Step 4	GAV is the higher of ER 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 1/3rd 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)1/3rd of ` 1,20,000	40,000	67,000
Income from Unit II (let-out)			**23,000**

Illustration 11

Mr. Anand sold his residential house property in March, 2017.

In June, 2017, he recovered rent of Rs.10,000 from Mr. Gaurav, to whom he had let out his house for two years from April 2011 to March 2013. He could not realise two month rent of Rs.20,000 from him and to that extent his actual rent was reduced while computing income from house property for A.Y.2013-14.

Further, he had let out his property from April, 2013 to February, 2017 to Mr. Satish. In April, 2015, he had increased the rent from Rs.12,000 to Rs.15,000 per month and the same was a subject matter of dispute. In September, 2017, the matter was finally settled and Mr. Anand received Rs.69,000 as

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arrears of rent for the period April 2015 to February, 2017.

Would the recovery of unrealised rent and arrears of rent be taxable in the hands of Mr. Anand, and if so in which year?

Solution

Since the unrealised rent was recovered in the P.Y.2017-18, the same would be taxable in the A.Y.2018-19 under section 25A, irrespective of the fact that Mr. Anand was not the owner of the house in that year. Further, the arrears of rent was also received in the P.Y.2017-18, and hence the same would be taxable in the A.Y.2018-19 under section 25A, even though Mr. Anand was not the owner of the house in that year. A deduction of 30% of unrealised rent recovered and arrears of rent would be allowed while computing income from house property of Mr. Anand for A.Y.2018-19.

Computation of income from house property of Mr. Anand for A.Y.2018-19

Particulars	`
(i) Unrealised rent recovered	10,000
(ii) Arrears of rent received	69,000
	79,000
Less: Deduction@30%	23,700
Income from house property	**55,300**

EXERCISE

Question 1

People Housing Ltd. is engaged in the business of constructing residential and commercial properties. One of the building properties was included in the closing stock in the Balance Sheet. The said building was let out for a monthly rent as suitable buyers could not be found. All other buildings had been sold by the company. Examine with reasons whether the income by way of rent from the unsold property is assessable as income from business or income from house property.

What would be your answer, if the main objective of the company was to hold properties and earn income by letting out of these properties?

Answer

(a) Under section 22, the charging section for "Income from house property", the only exception provided is the income derived from property used/occupied by the assessee for his own business. Therefore, income derived from letting out of house property will be taxable under

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the head "Income from house property". It will be so taxable even if property is held by the assessee as stock-in-trade of his business.

This has been further substantiated by insertion of new sub-section (5) of section 23, according to which income from house property held as stock-in-trade would be exempt for a period of one year from the end of the financial year in which certificate of completion was obtained from the competent authority. However, for availing such exemption, the property should not be let out during the said period. Insertion of sub-section (5) in section 23 providing for exemption in respect of house property held as stock-in-trade for a certain period subject to fulfilment of the condition stated therein implies that income from house property held as stock-in-trade –

(i) beyond the said period; or

(ii) not eligible for such exemption even during the said period due to non-fulfilment of the stated condition,

would be taxable under the same head of income i.e., "Income from house property".

In effect, where exemption provisions are provided under a particular head of income, it can be inferred that the income, but for such exemption, would be taxable only under that head of income.

Note –In the case of *New Delhi Hotels Ltd. v. ACIT (2014) 360 ITR 187*, the Delhi High Court followed its own decision in the case of *CIT vs. Discovery Estates Pvt. Ltd/CIT vs. Discovery Holding Pvt. Ltd.,* wherein it was held in the case of rental income derived from unsold flats which were shown as stock-in trade in the books of the assessee should be assessed under the head "Income from house property" and not under the head "Profits and gains from business and profession".

This decision is in sync with the intent of the provisions of section 22 and 23(5) discussed above.

(b) The Supreme Court, in Chennai Properties and Investments Ltd. v. CIT (2015) 373 ITR 673, held that where holding of properties and earning income by letting out of these properties is the main objective of the company as laid out in its Memorandum of Association and the entire income of the company as per its return of income accepted by the Assessing Officer comprises of income from letting out of such properties, such income would be assessable as "Profits and gains of business or profession."

Further, in case of Rayala Corporation (P) Ltd. v. Asstt. CIT (2016) 386 ITR 500, the Supreme Court held that since the business of the company is to lease out its property and earn

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rent therefrom, the rental income earned by the company is chargeable to tax as its business income and not income from house property.

Question 2

A Hindu undivided family owns a property which has been let out to a firm carrying on business. The family is a partner of the firm through its Karta. No rent has been charged by the HUF from the firm for use of the premises by the firm. The Assessing Officer, however, has taxed the family on the notional income from property based on municipal valuation. Is this decision justified?

Answer

Under section 22, the annual value of a property is chargeable to tax under the head "Income from house property" in the hands of the owner. However, this section specifically excludes property occupied for the purposes of own business or profession of the assessee, the profits of which are chargeable to income-tax. In CIT v. Shri. Champalal Jeevraj (1995) 215 ITR 289 (Mad), it was observed that where the Karta of the HUF is a partner in the firm in his representative capacity and the firm occupied a portion of the house belonging to the HUF, the benefit of exclusion under section 22 was available to the HUF. Hence, the income from the said property shall not be chargeable to tax under the head "Income from house property". Therefore, in this case, the action of the Assessing Officer is not correct.

Question 3

In the following cases, examine under which head of income the receipt would be assessed-

(a) Anirudh let out his property to Abhinav. Abhinav sublets it. How is sub-letting receipt to be assessed in the hands of Abhinav?

(b) Anish has built a house on a leasehold land. He has let-out the above property and has considered the rent from such property under the head "Income from other sources" and deducted expenses on repairs, security charges, insurance and collection charges in all amounting to 50% of receipts.

Answer

(a) Sub-letting receipt is to be assessed as "Income from Other Sources" or as "Profits and gains of business or profession" in hands of Mr. Abhinav, depending upon the facts and circumstances of each case. It is not assessable as income from house property, since one of the conditions for assessing an income under this head is that the assessee should be the owner of the property i.e. owner of the building and the land appurtenant thereto. In this case, since Abhinav is not the owner of the house property, sub-letting receipt cannot be assessed under the head "Income from

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house property".

(b) Since Anish is the owner of the property (building), in this case, the receipt would be assessable as "Income from house property". The ownership of land is not a pre-requisite for assessment of income under this head. 30% of Net Annual Value is allowed as a deduction under section 24.

Question 4

Rajesh owns a house in Hyderabad. During the previous year 2017-18, 3/4th portion of the house was self-occupied and 1/4th portion was let out for residential purposes at a rent of Rs.12,000 p.m. The tenant vacated the property on February 28th2018. The property was vacant during March, 2018. Rent for the months of January 2018 and February 2018 could not be realised in spite of the owner's efforts. All the conditions prescribed under Rule 4 are satisfied.

Municipal value of the property is Rs.4,00,000 p.a., fair rent is Rs.4,40,000 p.a. and standard rent is Rs.4,80,000. He paid municipal taxes @10% of municipal value during the year. A loan of Rs.30,00,000 was taken by him during the year 2009 for acquiring the property. Interest on loan paid during the previous year 2017-18 was Rs.1,48,000. Compute Rajesh's income from house property for the A.Y. 2018-19.

Answer

There are two units of the house. Unit I with 3/4th area is used by Rajesh 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 1/4th area is let-out during the previous year and its annual value has to be determined as per section 23(1).

Computation of Income from house property of Mr. Rajesh for the A.Y. 2018-19

Particulars		`
Unit I (3/4th area – self-occupied)		
Annual Value		Nil
Less: Deduction under section 24(b) 3/4th of Rs.1,48,000		1,11,000
Income from Unit I (self-occupied)		**(1,11,000)**
Unit II (1/4th area – let out)		
Computation of GAV		
Step 1 – Computation of Expected Rent (ER)		

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ER = Higher of municipal valuation (MV) and fair rent (FR), but restricted to standard rent (SR). However, in this case, standard rent of Rs.1,20,000 (1/4th of Rs. 4,80,000) is more than the higher of MV of Rs. 1,00,000 (1/4th of Rs. 4,00,000) and FR of Rs. 1,10,000 (1/4th of Rs.4,40,000). Hence the higher of MV and FR is the ER. In this case, it is the fair rent.	1,10,000	
Step 2 – Computation of actual rent received/ receivable Rs.12,000 9 = 1,08,000 [The property was let-out for 11 months. However, rent for 2 months i.e., January and February, 2018 could not be realized. As per Explanation to section 23(1), actual rent should not include any amount of rent which is not capable of being realized. Therefore, actual rent has been computed for 9 months]	1,08,000	
Step 3 – GAV is the higher of ER and actual rent received/receivable. However, as per section 23(1)(c), where the let-out property is vacant for part of the year and owing to vacancy, the actual rent is lower than the ER, then the actual rent received would be the GAV of the property. In this case, the actual rent is lower than the ER owing to vacancy, since had the property not been vacant in March 2018, the actual rent would have been Rs.1,20,000 (i.e. Rs.1,08,000 + Rs. 12,000), which is higher than the ER of Rs.1,10,000. Therefore, in this case, section 23(1)(c) would apply and the actual rent of Rs. 1,08,000 would be the GAV, since it is lower than the ER owing to vacancy.	1,08,000	
Gross Annual Value (GAV)		**1,08,000**
Less: Municipal taxes paid by the owner during the previous year relating to let-out portion 1/4th of (10% of Rs.4,00,000) =Rs.40000/4 = `10,000		10,000
Net Annual Value(NAV)		**98,000**
Less: Deductions under section 24		
(a) 30% of NAV = 30% of Rs.98,000	29,400	

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(b) Interest paid on borrowed capital (relating to let out portion) [1/4th of Rs.1,48,000]	37,000	66,400
Income from Unit II (let-out)		**31,600**
Loss under the head "Income from house property" (-1,11,000 + 31,600)		**-79,400**

Question 5

During the financial year 2017-18, Mr. A received a sum of Rs.1,80,000 (Rs.60,000 p.a.) by way of arrears for the last three years as the Government department (tenant) enhanced the rate of rent with retrospective effect. Will the sum of Rs.1,80,000 be taxable in the assessment year 2018-19? Can it be spread over the last three years?

Answer

As per section 25A, the arrears of rent shall be taxable in the previous year in which such arrears are received. The assessee shall be allowed deduction @ 30% of such amount received. Further, it is not necessary that the assessee should be owner of such house property in the previous year in which such arrears are received.

As the arrear rent of Rs.1,80,000 is received in the previous year 2017-18, the same is taxable in the A.Y.2018-19. Thus, the net sum of Rs.1,26,000 (i.e. Rs.1,80,000 – Rs.54,000) shall be chargeable to tax under the head "Income from house property".

There is no provision in the Income-tax Act, 1961, enabling the assessee to spread over the arrears of rent over the last three years.

SIGNIFICANT SELECT CASES

1. **Would income from letting out of properties by a company, whose main object as per its memorandum of association is to acquire and let out properties, be taxable as its business income or income from house property, considering the fact that the entire income of the company as per its return of income was only from letting out of properties? Chennai Properties and Investments Ltd. v. CIT (2015) 373 ITR 673 (SC)**

   Facts of the Case: The assessee-company was incorporated under the Companies Act, 1956. Its main objective, as stated in the memorandum of association, is to acquire properties in the city of Madras and let out those properties. The company had rented out such properties and the rental income was shown as its business income in the return filed by the assessee.

   The Assessing Officer, however, assessed the rental income under the head "Income from

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house property". On appeal, the Commissioner (Appeals) concurred with the assessee's view that the rental income, in this case, was the company's business income. The Appellate Tribunal also supported the view of the Commissioner (Appeals).

High Court's Opinion: The High Court allowed the Department's appeal holding that income derived from letting out of properties has to be assessed as income from house property. It held so on the basis of the Supreme Court ruling in East India Housing and Land Development Trust Ltd. v. CIT (1961) 42 ITR 9, wherein it was decided that income from letting out of shops and stalls was to be assessed as income from house property, in the case of a company whose main object of was buying and developing landed properties and promoting and developing markets.

Supreme Court's Observations: The Supreme Court observed that the High Court had pronounced its ruling on the basis of the decision of the Apex Court in East India Housing and Land Development Trust Ltd.'s case, wherein the letting out of property was not the object of the company at all. Therefore, in that case, the Apex Court was of the opinion that the character of the income which was from house property had not changed merely because it was received by the company formed with the object of developing and setting up properties.

The Supreme Court further observed the law laid down authoritatively and succinctly by it in Karanpura Development Co. Ltd. v. CIT [1962] 44 ITR 362. In that case, the assessee- company was formed with the object of, inter alia, acquiring and disposing of the underground coal mining rights in certain coal fields and it had restricted its activities to acquiring coal mining leases over large areas, developing them as coal fields and then sub-leasing them to collieries and other companies. Thus, in that case, the leasing out of the coal fields to the collieries and other companies was the business of the assessee. The income which was received from letting out of those mining leases was shown as business income. Department took the position that the same was to be treated as income from the house property. Thus, in similar circumstances, an identical issue arose before the Apex Court. The Apex Court pointed out that the deciding factor as to the head under which the income was to be assessed is not the ownership of land or leases but the nature of the activity of the assessee and the nature of the operations in relation to them. It was highlighted and stressed that the objects of the company must also be kept in view to interpret the activities. In support of the aforesaid proposition, a number of judgments of other jurisdictions, i.e., Privy Council, House of Lords in England and the US Courts were taken note of.

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After applying the aforesaid principle to the facts, the Apex Court had arrived at the conclusion that such income had to be treated as income from business and not as income from house property.

> **Supreme Court's Decision:** The Supreme Court opined that the aforesaid judgment in *Karanpura Development Co. Ltd.'s* case squarely applied to the facts of the present case, where letting of the properties is in fact the business of the assessee. The main objective of the company as per its memorandum of association is to acquire and hold properties in Chennai and let out these properties. Therefore, holding of the properties and earning income by letting out these properties is the main objective of the company. Further, in the return of income filed by the company and accepted by the Assessing Officer, the entire income of the company comprised of income from letting out of such properties. The Supreme Court, accordingly, held that the assessee had rightly disclosed the income derived from letting out of such properties under the head "Profits and gains of business or profession".

2. **Would rental income from the business of leasing out properties be taxable under the head "Income from house property" or "Profits and gains from business or profession"?**

Rayala Corporation (P) Ltd. v. Asstt. CIT (2016) 386 ITR 500 (SC)

Facts of the case: The assessee company was in the business of renting its properties and received rent which it claims as its business income chargeable under the head "Profits and Gains from business or profession". The Assessing Officer, however, brought to tax the rental income under the head "Income from house property".

Appellate Authorities' views: The Appellate Tribunal and the High Court affirmed the view of the Assessing Officer holding that the rental income from letting out of properties is to be taxed under the head "Income from house property".

Supreme Court's Observations: The Apex Court took note of the specific finding by the authorities that the assessee had stopped its other business activities and continued only the business of leasing out its properties and earning rent therefrom. Thus, it noted that the assessee

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was engaged only in the business of renting its properties and earning rental income. It made reference to law laid down by it in Chennai Properties & Investments Ltd v. CIT (2015) 373 ITR 673 (SC) that if an assessee is engaged in the business of letting out house property on rent, then, the income from such property, even though in the nature of rent, should be treated as business income. The Court held that the judgment in Chennai Properties & Investment Ltd.'s case would squarely apply in this case also, since the company is engaged in the business of letting out properties and earning rental income therefrom. It did not concur with the contention of

Supreme Court's decision: The Apex Court, thus, held that since the business of the company is to lease out its property and earn rent therefrom, the rental income earned by the company is chargeable to tax as its business income and not income from house property.

the Revenue that rent should be the main source of income or that the purpose for which the company was formed/incorporated should be to earn rental income, so as to make the income taxable under the head 'Profits and gains of business or profession".

3. **Whether the rental income derived from the unsold flats which are shown as stock-in- trade in the books of the assessee would be taxable under the head 'Profits and gains from business or profession' or under the head 'Income from house property', in a case where the actual rent receipts formed the basis of computation of income?**

New Delhi Hotels Ltd. v. ACIT (2014) 360 ITR 0187 (Delhi]

High Court's Observations: On this issue, in CIT v. Ansal Housing Finance and Leasing Co. Ltd. (2013) 354 ITR 180, where the deemed rent (i.e., Expected Rent) formed the basis of computation of income from unsold flats held as stock-in-trade, the Delhi High Court held that such rent was taxable under the head "Income from house property". Further, in CIT v. Discovery Estates Pvt. Ltd. and CIT v. Discovery Holding Pvt. Ltd. (2013) 356 ITR 159, the same issue emerged when the actual rent formed the basis of computation of income from unsold flats held

High Court's Decision: In this case, the Delhi High Court followed its own decision in the case of *CIT vs. Discovery Estates Pvt. Ltd / CIT vs. Discovery Holding Pvt. Ltd.,* wherein it was held that rental income derived from unsold flats which were shown as stock-in-trade in the books of the assessee should be assessed under the head "Income from house property" and not under the head "Profits and gains from business or profession".

as stock-in-trade. In that case also, the Delhi High Court held that the income was taxable under the head "Income from house property".

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Note *– This has been further substantiated by insertion of new sub-section (5) of section 23, according to which income from house property held as stock-in-trade would be exempt for a period of one year from the end of the financial year in which certificate of completion was obtained from the competent authority. However, for availing such exemption, the property should not be let out during the said period. Insertion of sub-section (5) in section 23 providing for exemption in respect of house property held as stock-in-trade for a certain*

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period subject to fulfilment of the condition stated therein implies that income from house property held as stock-in-trade –

(i) beyond the said period; or

(ii) not eligible for such exemption even during the said period due to non-fulfilment of the stated condition,

would be taxable under the same head of income i.e., "Income from house property".

In effect, where exemption provisions are provided under a particular head of income, it can be inferred that the income, but for such exemption, would be taxable only under that head of income.

4. Under what head of income should income from letting out of godowns and provision of warehousing services be subject to tax - "Income from house property" or "profits and gains of business or profession"?

CIT v. NDR Warehousing P Ltd (2015) 372 ITR 690 (Mad)

Facts of the case: The assessee engaged in the business of warehousing, handling and transport business claimed income from letting out of buildings and godowns as business income. The Assessing Officer assessed such income as "Income from house property".

Appellate Authorities' Observations: The Commissioner (Appeals) observed that the assessee's activity was not merely letting out of warehouses but storage of goods with provision of several auxiliary services such as pest control, rodent control and fumigation service to prevent the goods stored from being affected by vagaries of moisture and temperature. Further, service of security and protection was also provided to the goods stored. There is, therefore, no dispute that the assessee carries on the activity in an organised manner. These activities are more than mere letting out of the godown for tenancy.

The Tribunal noted that the objects clause of the memorandum of association of the company clearly shows that the assessee-company was incorporated with the object of carrying on the business of warehousing and letting/renting of godowns and providing facilities for storage of articles or things and descriptions whatsoever. The profit and loss account of the assessee-company shows that its main source of income is storage charges and maintenance or user charges. Even substantial part of the expenses also relate to the salaries of employees engaged in the maintenance and upkeep of the godowns and warehouses. Based on these facts, Tribunal concurred with the findings of the Commissioner (Appeals) and held that the income of the assessee from letting out of warehouses and godowns is chargeable under the head "Profits and gains of business or profession" and not "Income from house property".

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High Court's Decision: The High Court observed that the Commissioner (Appeals) as well as the Tribunal had not only gone into the objects clause of the memorandum of the assessee but also individual aspects of the business to come to the conclusion that it was a case of warehousing business, and, therefore, the income would fall under the head "Profits and gains of business or profession".

Accordingly, the High Court held that the income earned by the assessee from letting out of godowns and provision of warehousing services is chargeable to tax under the head "Profits and gains of business or profession" and not under the head "Income from house property".

5. **Can benefit of self-occupation of house property under section 23(2) be denied to a HUF on the ground that it, being a fictional entity, cannot occupy a house property?**

CIT v. Hariprasad Bhojnagarwala (2012) 342 ITR 69 (Guj.) (Full Bench)

Facts of the case: The assessee, being a Hindu Undivided Family (HUF), claimed the benefit of self-occupation of a house property under section 23(2). However, the Assessing Officer did not accept the said claim and denied the benefit of self-occupation of house property to the HUF contending that such benefit is available only to the owner who can reside in his own residence i.e., only an individual assessee, who is a natural person, and not to an imaginary assessable entity being HUF or a firm, etc.

High Court's Observations & Decision: On the abovementioned issue, the Gujarat High Court observed that a firm, which is a fictional entity, cannot physically reside in a house property and therefore a firm cannot claim the benefit of this provision, which is available to an individual owner who can actually occupy the house. However, the HUF is a group of individuals related to each other i.e., a family comprising of a group of natural persons. The said family can reside in the house, which belongs to the HUF. Since a HUF cannot consist of artificial persons, it cannot be said to be a fictional entity. Also, it was observed that since singular includes plural, the word "owner" would include "owners" and the words "his own" used in section 23(2) would include "their own".

Therefore, the Court held that the HUF is entitled to claim benefit of self-occupation of house property under section 23(2).

6. **Can notional interest on interest-free deposit received by an assessee in respect of a shop let out on rent be brought to tax as business income or income from house property?**

CIT v. Asian Hotels Ltd. (2010) 323 ITR 490 (Del.)

Facts of the case: The assessee had received interest-free deposit in respect of shops given on rent. The Assessing Officer added to the assessee's income notional interest on the

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interest free deposit at the rate of 18 per cent simple interest per annum on the ground that by accepting the interest free deposit, a benefit had accrued to the assessee which was chargeable to tax under section 28(iv).s

High Court's Observations & Decision: The High Court observed that section 28(iv) is concerned with business income and brings to tax the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession. Section 28(iv) can be invoked only where the benefit or amenity or perquisite is otherwise than by way of cash. In the instant case, the Assessing Officer has determined the monetary value of the benefit stated to have accrued to the assessee by adding a sum that constituted 18% simple interest on the deposit. Hence, section 28(iv) is not applicable.

Section 23(1) deals with the determination of the expected rent of a let out property for computing the income from house property. It provides that the expected rent is deemed to be the sum for which the property might reasonably be expected to be let out from year to year. This contemplates the possible rent that the property might fetch and certainly not the interest on fixed deposit that may be placed by the tenant with the landlord in connection with the letting out of such property. Thus, the notional interest is neither assessable as business income nor as income from house property.

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Question 1: Preamble of ICDS I states that this ICDS is applicable for computation of income chargeable under the head "Profits and gains of business or profession" or "Income from other sources" and not for the purposes of maintenance of books of account. However, Para 1 of ICDS I states that it deals with significant accounting policies. Accounting policies are applied for maintenance of books of accounts and preparing financial statements. What is the interplay between ICDS I and maintenance of books of accounts?

Answer: As stated in the Preamble, ICDS is not meant for maintenance of books of accounts or preparing financial statements. Persons are required to maintain books of accounts and prepare financial statements as per accounting policies applicable to them. For example, companies are required to maintain books of account and prepare financial statements as per requirements of Companies Act, 2013. The accounting policies mentioned in ICDS-I being fundamental in nature shall be applicable for computing income under the heads "Profits and gains of business or profession" or "Income from other sources".

Question 2: Certain ICDS provisions are inconsistent with judicial precedents. Whether these judicial precedents would prevail over ICDS?

Answer: The ICDSs have been notified after due deliberation and after examining judicial views for bringing certainty on the issues covered by it. Certain judicial pronouncements w ere pronounced in the absence of authoritative guidance on these issues under the Act for computing Income under the head "Profits and gains of business or profession" or Income from other sources. Since certainty is now provided by notifying ICDS under section 145(2), the provisions of ICDS shall be applicable to the transactional issues dealt therein in relation to assessment year 2017 -18 and subsequent assessment years.

Question 3: Does ICDS apply to non-corporate taxpayers who are not required to maintain books of account and/or those who are covered by presumptive scheme of taxation like sections 44AD, 44AE, 44ADA, 44B, 44BB, 44BBA, etc. of the Act?

Answer: ICDS is applicable to specified persons having income chargeable under the head 'Profits and gains of business or profession' or 'Income from other sources'. Therefore, the relevant provisions of ICDS shall also apply to the persons computing income under the relevant presumptive taxation scheme. For example, for computing presumptive income of a part nership firm under section 44AD of the Act, the provisions of ICDS on Construction Contract or Revenue recognition shall apply for determining the receipts or turnover, as the case may be.

Question 4: If there is conflict between ICDS and other specific provisions of the Income -tax Rules, 1962 governing taxation of income like rules 9A, 9B etc. of the Rules, which provisions shall prevail?

Answer: ICDS provides general principles for computation of income. In case of conflict, if any, between the provisions of Rules and ICDS, the provisions of Rules, which deal with specific circumstances, shall prevail.

Question 5: ICDS is framed on the basis of accounting standards notified by Ministry of Corporate Affairs (MCA) vide Notification No. GSR 739(E) dated 7th December, 2006 under section 211(3C) of erstwhile Companies Act 1956. However, MCA has notified in February, 2015 a new set of standards called 'Indian Accounting Standards' (Ind -AS). How will ICDS apply to

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companies which adopted Ind-AS?

Answer: ICDS shall apply for computation of taxable income under the head "Profit and gains of business or profession" or "Income from other sources" under the Income -tax Act. This is irrespective of the accounting standards adopted by companies i.e. either Accounting Standards or Ind-AS.

Question 6: Whether ICDS shall apply to computation of Minimum Alternate Tax (MAT) under section 115JB of the Act or Alternate Minimum Tax (AMT) under section 115JC of the Act?

Answer: MAT under section 115JB of the Act is computed on 'book profit' that is net profit as shown in the Profit and Loss Account prepared under the Companies Act subject to certain specified adjustments. Since, the provisions of ICDS are applicable for computa tion of income under the regular provisions of the Act, the provisions of ICDS shall not apply for computation of MAT.

AMT under section 115JC of the Act is computed on adjusted total income which is derived by making specified adjustments to total income computed as per the regular provisions of the Act. Hence, the provisions of ICDS shall apply for computation of AMT.

Question 7: Whether the provisions of ICDS shall apply to Banks, Non -banking financial institutions, Insurance companies, Power sector, etc.?

Answer: The general provisions of ICDS shall apply to all persons unless there are sector specific provisions contained in the ICDS or the Act. For example, ICDS VIII contains specific provisions for banks and certain financial institutions and Schedule I of the Act contains specific provisions for Insurance business.

Question 8: Para 4(ii) of ICDS-1 provides that Mark to Market (MTM) loss or an expected loss shall not be recognized unless the recognition is in accordance with the provisions of any othe r ICDS. Whether similar consideration applies to recognition of MTM gain or expected incomes?

Answer: Same principle as contained in ICDS-I relating to MTM losses or an expected loss shall apply mutatis mutandis to MTM gains or an expected profit.

Question 9: ICDS-1 provides that an accounting policy shall not be changed without 'reasonable cause'. The term 'reasonable cause' is not defined. What shall constitute 'reasonable cause'?

Answer: Under the Act, 'reasonable cause' is an existing concept and has ev olved well over a period of time conferring desired flexibility to the tax payer in deserving cases.

Question 10: Which ICDS would govern derivative instruments?

Answer: ICDS -VI (subject to para 3 of ICDS-III) provides guidance on accounting for derivative contracts such as forward contracts and other similar contracts. For derivatives, not within the scope of ICDS-VI, provisions of ICDS-1 would apply.

Question 11: Whether the recognition of retention money, receipt of which is contingent on the satisfaction of certain performance criterion is to be recognized as revenue on billing?

Answer: Retention money, being part of overall contract revenue, shall be recognised as revenue subject to reasonable certainty of its ultimate collection condition contained i n para 9 of ICDS III on Construction contracts.

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Question 12: Since there is no specific scope exclusion for real estate developers and Build - Operate-Transfer (BOT) projects from ICDS IV on Revenue Recognition, please clarify whether ICDS-III and ICDS-IV should be applied by real estate developers and BOT operators. Also, whether ICDS is applicable for leases.

Answer: At present, there is no specific ICDS notified for real estate developers, BOT projects and leases. Therefore, relevant provisions of the Act and ICDS shall apply to these transactions as may be applicable.

Question 13: The condition of reasonable certainty of ultimate collection is not laid down for taxation of interest, royalty and dividend. Whether the taxpayer is obliged to account for such income even when the collection thereof is uncertain?

Answer: As a principle, interest accrues on time basis and royalty accrues on the basis of contractual terms. Subsequent non-recovery in either cases can be claimed as deduction in view of amendment to section 36(1)(vii). Further, the provision of the Act (e.g. Section 43D) shall prevail over the provisions of ICDS.

Question 14: Whether ICDS is applicable to revenues which are liable to tax on gross basis like interest, royalty and fees for technical services for non-residents u/s. 115A of the Act.

Answer: Yes, the provisions of ICDS, also apply for computation of these incomes o n gross basis for arriving at the amount chargeable to tax.

Question 15: Para 8 of ICDS-V states expenditure incurred on commissioning of project, including expenditure incurred on test runs and experimental production shall be capitalized. It also states that expenditure incurred after the plant has begun commercial production i.e., production intended for sale or captive consumption shall be treated as revenue expenditure. What shall be the treatment of expense incurred after the conduct of test runs and experimental production but before commencement of commercial production?

Answer: As clarified in Para 8 of ICDS-V, the expenditure incurred till the plant has begun commercial production, that is, production intended for sale or captive consumption, shall be treated as capital expenditure.

Question 16: What is the taxability of opening balance as on 1st April 2016 of Foreign Currency Translation Reserve (FCTR) relating to non-integral foreign operation, if any, recognised as per Accounting Standards (AS) 11?

Answer: FCTR balance as on 1 April 2016 pertaining to exchange differences on monetary items for non-integral operations, shall be recognised in the previous year relevant for assessment year 2017-18 to the extent not recognised in the income computation in the past.

Question 17: For subsidy received prior to 1st April 2016 but not recognised in the books pending satisfaction of related conditions and achieving reasonable certainty of receipt, how shall the same be recognised under ICDS on or after 1st April 2016?

Answer: Para 4 of ICDS-VII read with Para 5 to Para 9 of ICDS-VII provides for timing of recognition of government grant. The transitional provision in Para 13 of ICDS -VII provides that a government grant which meets the recognition criteria on or after 1st April 2016 shall be recognised in accordance with ICDS-VII. All government grants actually received prior to 1st April 2016 shall be

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deemed to have been recognised on its receipt in accordance with Para 4(2) of ICDS-VII and accordingly will be outside the transitional provision and therefore the government grants received on or after 1st April 2016 and for which recognition criteria provided in Para 5 to Para 9 of ICDS-VII is also satisfied thereafter, the same shall be recognised as per the p rovisions of ICDS-VII. The grants received prior to 1st April 2016 shall continue to be recognised as per the law prevailing prior to that date.

For example, if out of total subsidy entitlement of Rs.10 Crore an amount of Rs.6 Crore is recognised in the books of account till 31st March 2016 and recognition of balance Rs. 4 Crore is deferred pending satisfaction of related conditions and/or achieving reasonable certainty of receipt. The balance amount of Rs.4 Crore will be taxed in the year in which related conditions are met and reasonable certainty is achieved. If these conditions are met over two years, the amount of Rs.4 Crore shall be taxed over the period of two years. The amount of Rs.6 Crore for which recognition criteria were met prior to 1st April 2016 shall not be taxable post 1st April 2016.

But if the subsidy is already received prior to 1st April 2016, Para 13 of ICDS -VII shall not apply even if some of the related conditions are met on or after 1 April 2016. This is in view of Para 4(2) of ICDS-VII which provides that Government grant shall not be postponed beyond the date of actual receipt. Such grants shall continue to be governed by the provisions of law applicable prior to 1st April 2016.

Question 18: If the taxpayer sells a security on 30th April 2017. The interest payment dates are December and June. The actual date of receipt of interest is on 30 th June 2017 but the interest on accrual basis has been accounted as income on 31st March 2017. Whether the taxpayer shall be permitted to claim deduction of such interest i.e. offered to tax but not received while computing the capital gain?

Answer: Yes, the amount already taxed as interest income on accrual basis shall be taken into account for computation of income arising from such sale.

Question 19: Para 9 of ICDS-VIII on securities requires securities held as stock-in-trade shall be valued at actual cost initially recognised or net realisable value (NRV) at the end of that previous year, whichever is lower. Para 10 of Part-A of ICDS-VIII requires the said exercise to be carried out category wise. How the same shall be computed?

Answer: For subsequent measurement of securities held as stock-in-trade, the securities are first aggregated category wise. The aggregate cost and NRV of each category of secu rity are compared and the lower of the two is to be taken as carrying value as per ICDS-VIII. This is illustrated below -

Security	Category	Cost	NRV	Lower of cost or NRV	ICDS Value
A	Share	100	75	75	
B	Share	120	150	120	
C	Share	140	120	120	

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D	Share	200	190	190	
	Total	**560**	**535**	**505**	**535**
E	Debt Security	150	160	150	
F	Debt Security	105	90	90	
G	Debt Security	125	135	125	
H	Debt Security	220	230	220	
	Total	**600**	**615**	**585**	**600**
Securities Total		**1160**	**1150**	**1090**	**1135**

Question 20: There are specific provisions in the Act read with Rules under which a portion of borrowing cost may get disallowed under sections like 14A, 43B, 40(a)(i), 40(a)(ia), 40A(2)(b), etc. of the Act. Whether borrowing costs to be capitalized under ICDS -IX should exclude portion of borrowing costs which gets disallowed under such specific provisions?

Answer: Since specific provisions of the Act override the provisions of ICDS, it is clarified that borrowing costs to be considered for capitalization under ICDS IX shall exclude those borrowing costs which are disallowed under specific provisions of the Act. Capitalization of borrowing cost shall apply for that portion of the borrowing cost which is otherwise allowable as deduction under the Act.

Question 21: Whether bill discounting charges and other similar charges would fall under the definition of borrowing cost?

Answer: The definition of borrowing cost is an inclusive definition. Bill discounting charges and other similar charges are covered as borrowing cost.

Question 22: How to allocate borrowing costs relating to general borrowing as computed in accordance with formula provided under Para 6 of ICDS-IX to different qualifying assets?

Answer: The capitalization of general borrowing cost under ICDS-IX shall be done on asset by-asset basis.

Question 23: What is the impact of Para 20 of ICDS X containing transitional provisions?

Answer: Para 20 of ICDS X provides that all the provisions or assets and related income shall be recognised for the previous year commencing on or after 1st day of April 2016 in accordance with the provisions of this standard after taking into account the amount recognised, if any, for the same for any previous year ending on or before 31st day of March, 2016.

The intent of transitional provision is that there is neither 'double taxation' of income due to application of ICDS nor there should be escapement of any income due to application of ICDS from a particular date. This is explained as under –

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Provision required as per ICDS on 31 March 2017 for items brought forward from 31st day of March 2016 (A)	INR 3 Crores
Provisions as per ICDS for FY 2016-17 (B)	INR 5 Crores
Total gross provision (C) =(A)+(B)	INR 8 Crores
Less: Provision already recognised for computation of taxable incom e in FY 2016-17 or earlier (D)	INR 2 Crores
Net provisions as per ICDS in FY 2016-17 to be recognised as per transition provision (E) = (C) - (D)	**INR 6 Crores**

Question 24: Expenditure on most post-retirement benefits like provident fund, gratuity, etc. are covered by specific provisions. There are other post-retirement benefits offered by companies like medical benefits. Such benefits are covered by AS-15 for which no parallel ICDS has been notified. Whether provision for these liabilities are excluded from scope of ICDS X?

Answer: It is clarified that provisioning for employee benefit which are otherwise covered by AS 15 shall continue to be governed by specific provisions of the Act and are not dealt with by ICDS -X.

Question 25: ICDS-1 requires disclosure of significant accounting policies and other ICDS requires specific disclosures. Where is the taxpayer required to make such disclosures specified in ICDS?

Answer: Net effect on the income due to application of ICDS is to be disclosed in the Return of income. The disclosures required under ICDS shall be made in the tax audit report in Form 3CD. However, there shall not be any separate disclosure requirements for persons who are not liable to tax audit.

Illustration 1

Mr. X, a proprietor engaged in manufacturing business, furnishes the following particulars:

	Particulars	`
(1)	Opening WDV of plant and machinery as on 1.4.2017	30,00,000
(2)	New plant and machinery purchased and put to use on 08.06.2017	20,00,000
(3)	New plant and machinery acquired and put to use on 15.12.2017	8,00,000
(4)	Computer acquired and installed in the office premises on 2.1.2018	3,00,000

Compute the amount of depreciation and additional depreciation as per the Income -tax Act, 1961 for the A.Y. 2018-19

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Solution

Computation of depreciation and additional depreciation for A.Y. 201 8-19

Particulars	Plant & Machinery (15%) (`)	Computer (40%) (`)
Normal depreciation		
• @ 15% on Rs.50,00,000 **[See Working Notes 1 & 2]**	7,50,000	-
• @ 7.5% (50% of 15%, since put to use for less than 180 days) on Rs.8,00,000	60,000	-
• @ 20% (50% of 40%, since put to use for less than 180 days) on Rs.3,00,000	-	60,000
Additional Depreciation		
• @ 20% on Rs.20,00,000 (new plant and machinery put to use for more than 180 days)	4,00,000	-
• @10% (50% of 20%, since put to use for less than 180 days) on Rs.8,00,000	80,000	-
Total depreciation	**12,90,000**	**60,000**

Working Notes:

(1) Computation of written down value of Plant & Machinery as on 31.03.2018

Particulars	Plant & Machinery (`)	Computer (`)
Written down value as on 1.4.2017	30,00,000	-
Add: Plant & Machinery purchased on 08.6.2017	20,00,000	-
Add: Plant & Machinery acquired on 15.12.2017	8,00,000	-
Computer acquired and installed in the office premises	-	3,00,000
Written down value as on 31.03.2018	**58,00,000**	**3,00,000**

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(2) Composition of plant and machinery included in the WDV as on 31.3.2018

Particulars	Plant & Machinery (Rs.)	Computer (Rs.)
Plant and machinery put to use for 180 days or more	50,00,000	
[Rs.30,00,000 (Opening WDV) + Rs.20,00,000 (purchased on 8.6.2017)]		
Plant and machinery put to use for less than 180 days	8,00,000	
Computers put to use for less than 180 days		3,00,000
	58,00,000	**3,00,000**

Notes:

1. As per the second proviso to section 32(1)(ii), where an asset acquired during the previous year is put to use for less than 180 days in that previous year, the amount of deduction allowable as normal depreciation and additional depreciation would be restricted to 50% of amount computed in accordance with the prescribed percentage.

   Therefore, normal depreciation on plant and machinery acquired and put to use on 15.12.2017 and computer acquired and installed on 02.01.2018, is restricted to 50% of 15% and 40%, respectively. The additional depreciation on the said plant and machinery is restricted to Rs.80,000, being 10% (i.e., 50% of 20%) of Rs.8 lakh.

2. As per third proviso to section 32(1)(ii), the balance additional depreciation of Rs.80,000 being 50% of Rs.1,60,000 (20% of Rs.8,00,000) would be allowed as deduction in the A.Y.2019-20

3. As per section 32(1)(iia), additional depreciation is allowable in the case of any new machinery or plant acquired and installed after 31.3.2005 by an assessee engaged, inter alia, in the business of manufacture or production of any article or thing, @20% of the actual cost of such machinery or plant.

   However, additional depreciation shall not be allowed in respect of, inter alia, any machinery or plant installed in office premises, residential accommodation or in any guest house.

   Accordingly, additional depreciation is not allowable on computer installed in the office premises.

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Illustration 2

A newly qualified Chartered Accountant Mr. Dhaval, commenced practice and has acquired the following assets in his office during F.Y. 2017-18 at the cost shown against each item. Calculate the amount of depreciation that can be claimed from his professional income for A.Y.2018-19:

Sl. No.	Description	Date of acquisition	Date when put to use	Amount `
1.	Computer including computer software	27 Sept., 17	1 Oct., 17	35,000
2.	Computer UPS	2 Oct., 17	8 Oct., 17	8,500
3.	Computer printer	1 Oct., 17	1 Oct., 17	12,500
4.	Books (of which books being annual publications are of Rs. 12,000)	1 Apr., 17	1 Apr., 17	13,000
5.	Office furniture (Acquired from a practising C.A.)	1 Apr., 17	1 Apr., 17	3,00,000
6.	Laptop	26 Sep., 17	8 Oct., 17	43,000

Solution

Computation of depreciation allowable for A.Y.2018-19

	Asset	Rate	Depreciation
Block 1	Furniture	10%	30,000
Block 2	Plant (Computer including computer software, computer UPS, laptop, printers & books)	40%	34,550
Total depreciation allowable			**64,550**

Notes:

1. Computation of depreciation

Block of Assets	`
Block 1: Furniture – [Rate of depreciation - 10%]	
Put to use for more than 180 days [Rs. 3,00,000@10%]	30,000

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Block 2: Plant [Rate of depreciation - 40%]		
(a)	Computer including computer software (put to use for more than 180 days) [Rs.35,000 @ 40%]	14,000
(b)	Computer Printer (put to use for more than 180 days) [Rs.12,500 @ 40%]	5,000
(c)	Laptop (put to use for less than 180 days) [Rs.43,000 @ 20%]	8,600
(d)	Computer UPS (put to use for less than 180 days) [Rs.8,500@ 20%]	1,700
(e)	Books (other than annual publications) (Put to use for more than 180 days) [Rs.1,000 @ 40%]	400
(f)	Books (being annual publications) put to use for more than 180 days) [Rs.12,000 @ 40%]	4,800
		34,550

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 t he prescribed rate. In this case, since Mr. Dhaval commenced his practice in the P.Y.2017-18 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 UPS.

Illustration 3

Sai Ltd. has a block of assets carrying 15% rate of depreciation, whose written down value on 01.04.2017 was Rs.40 lacs. It purchased another asset (second-hand plant and machinery) of the same block on 01.11.2017 for Rs.14.40 lacs and put to use on the same day. Sai Ltd. was amalgamated with Shirdi Ltd. with effect from 01.01.2018.

You are required to compute the depreciation allowable to Sai Ltd. & Shirdi Ltd. for the previous year ended on 31.03.2018 assuming that the assets were transferred to Shirdi Ltd. at Rs.60 lacs.

Solution

Statement showing computation of depreciation allowable to Sai Ltd. & Shirdi Ltd. for A.Y. 2018-19

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Particulars	`
Written down value (WDV) as on 1.4.2017	40,00,000
Addition during the year (used for less than 180 days)	14,40,000
Total	**54,40,000**
Depreciation on Rs.40,00,000 @ 15%	6,00,000
Depreciation on Rs.14,40,000 @ 7.5%	1,08,000
Total depreciation for the year	**7,08,000**
Apportionment between two companies:	
(a) Amalgamating company, Sai Ltd.	
Rs.6,00,000 × 275/365	4,52,055
Rs.1,08,000 × 61/151	43,629
	4,95,684
(b) Amalgamated company, Shirdi Ltd.	
Rs.6,00,000 × 90/365	1,47,945
Rs.1,08,000 × 90/151	64,371
	2,12,316

Notes:

(i) The aggregate deduction, in respect of depreciation allowable to the amalgamating company and amalgamated company in the case of amalgamation shall not exceed in any case, the deduction calculated at the prescribed rates as if the amalgamation had not taken place. Such deduction shall be apportioned between the amalgamating company and the amalgamated company in the ratio of the number of days for which the assets were used by them.

(ii) The price at which the assets were transferred, i.e., Rs.60 lacs, has no implication in computing eligible depreciation.

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Illustration 4

Lights and Power Ltd. engaged in the business of generation of power, furnishes the following particulars pertaining to P.Y. 2017-18. Compute the depreciation allowable under section 32 for A.Y. 2018-19, while computing his 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 01.04.2017 (Purchase value ` 8,00,000)*	*5,78,000*
2.	*Purchase of second hand machinery (15% block) on 29.12.2017 for business purpose*	*2,00,000*
3.	*Machinery Y (15% block) purchased and installed on 12.07.2017 for the purpose of power generation*	*8,00,000*
4.	*Acquired and installed for use a new air pollution control equipment on 31.7.2017*	*2,50,000*
5.	*New air conditioner purchased and installed in office premises on 8.9.2017*	*3,00,000*
6.	*New machinery Z (15% block) acquired and installed on 23.11.2017 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 01.04.2017 ` 3,46,800)*	*3,10,000*

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Solution

Computation of depreciation allowance under section 32 for the A.Y. 2018-19

Particulars	(`)	Plant and Machinery (15%) (`)	Plant and Machinery (40%) (`)
Opening WDV as on 01.04.2017		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	3,25,000	16,25,000	
- Air pollution control equipment		-	2,50,000
		22,03,000	2,50,000
Less: Asset sold during the year		3,10,000	Nil
Written down value before charging depreciation		18,93,000	2,50,000
Normal depreciation			
40% on air pollution control equipment (Rs.2,50,000 x 40%)		-	1,00,000
Depreciation on plant and machinery put to use for less than 180 days@ 7.5% (i.e., 50% of 15%)			
- Second hand machinery (Rs.2,00,000 × 7.5%)	15,000		

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- Machinery Z (Rs.3,25,000 × 7.5%)	24,375	39,375	
15% on the balance WDV being put to use for more than 180 days (Rs.13,68,000 × 15%)		2,05,200	
Additional depreciation			
- Machinery Y (Rs.8,00,000 × 20%)	1,60,000		
- Machinery Z (Rs.3,25,000 × 10%, being 50% of 20%)	32,500		
- Air pollution control equipment (`2,50,000× 20%)	50,000	2,42,500	50,000
Total depreciation		**4,87,075**	**1,50,000**

Notes:

(i) Power generation equipments qualify for claiming additional depreciation in respect of new plant and machinery.

(ii) Additional depreciation is not allowed in respect of second hand machinery.

(iii) No additional depreciation is allowed in respect of office appliances. Hence, no depreciation is allowed in respect of air conditioner installed in office premises.

(iv) The balance 50% additional depreciation in respect of Machinery Z of Rs. 32,500 (10% x Rs.3,25000) can be claimed as deduction in subsequent financial year i.e., F.Y. 2018-19.

Illustration 5

X Ltd. set up a manufacturing unit in Warangal in the state of Telangana on 01.06.2017. It invested Rs.30 crore in new plant and machinery on 1.6.2017. Further, it invested Rs.25 crore in the plant and machinery on 01.11.2017, out of which Rs.5 crore was second hand plant and machinery. Compute the depreciation allowable under section 32. Is X Ltd. entitled for any other benefit in respect of such investment? If so, what is the benefit available?

Solution

(i) Computation of depreciation under section 32 for X Ltd. for A.Y. 2018-19

Particulars	` (in crores)
Plant and machinery acquired on 01.06.2017	30.000
Plant and machinery acquired on 01.11.2017	25.000
WDV as on 31.03.2018	**55.000**

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Less: Depreciation @ 15% on Rs.30 crore	4.500	
Depreciation @ 7.5% (50% of 15%) on Rs.25 crore	1.875	
Additional Depreciation@35% on Rs.30 crore	10.500	
Additional Depreciation@17.5% (50% of 35%) on Rs.20 crore	3.500	20.375
WDV as on 01.04.2018		**34.625**

Computation of deduction under section 32AD for X Ltd. for A.Y. 2018-19

Particulars	(in crores)
Deduction under section 32AD @ 15% on Rs.50 crore	7.50
Total benefit	**7.50**

Notes:

(1) As per the second proviso to section 32(1)(ii), where an asset acquired during the previous year is put to use for less than 180 days in that previous year, the amount deduction allowable as normal depreciation and additional depreciation would be restricted to 50% of amount computed in accordance with the prescribed percentage.

Therefore, normal depreciation on plant and machinery acquired and put to use on 1.11.2017 is restricted to 7.5% (being 50% of 15%) and additional depreciation is restricted to 17.5% (being 50% of 35%).

(2) The balance additional depreciation of Rs.3.5 crore, being 50% of Rs.7 crore (35% of Rs.20 crore) would be allowed as deduction in the A.Y.2019-20.

(3) As per section 32(1)(iia), additional depreciation is allowable in the case of any new machinery or plant acquired and installed after 31.3.2005 by an assessee engaged, inter alia, in the business of manufacture or production of any article or thing. In this case, since new plant and machinery acquired was installed by a manufacturing unit set up in a notified backward area in the State of Telengana, the rate of additional depreciation is 35% of actual cost of new plant and machinery. Since plant and machinery of Rs.20 crore was put to use for less than 180 days, additional depreciation@17.5% (50% of 35%) is allowable as deduction. However, additional depreciation shall not be allowed in respect of second hand plant and machinery of Rs.5 crore.

Likewise, the benefit available under sections 32AD would not be allowed in respect of second hand plant and machinery.

Accordingly, additional depreciation and investment allowance under section 32AD have not been provided on Rs.5 crore, being the actual cost of second hand plant and machinery acquired and installed in the previous year.

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Illustration 6

A Ltd., engaged in the business of manufacturing, furnishes the following particulars for the P.Y.2017-18. Compute the deduction allowable under section 35 for A.Y.2018 -19, 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.2018-19

Particulars	`	Section	% of weighted deduction	Amount of deduction (`)
Payment for scientific research				
Indian Institute of Science	1,00,000	35(1)(ii)	150%	1,50,000
IIT, Delhi	2,50,000	35(2AA)	150%	3,75,000
X Ltd.	4,00,000	35(1)(iia)	100%	4,00,000
Expenditure incurred on in-house research and development facility				

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Revenue expenditure	3,00,000	35(2AB))	150%	4,50,000
Capital expenditure (excluding cost of acquisition of land ` 5,00,000)	2,50,000	35(2AB)	150%	3,75,000
Deduction allowable under section 35				**17,50,000**

(i) Section 32 allows depreciation in respect of assets including certain intangible assets. Section 35ABB provides for amortisation of licence fee in case of telecommunication service.

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 1.4.2017. He incurred capital expenditure of Rs.80 lakh, Rs.60 lakh and Rs.50 lakh, respectively, on purchase of land and building during the period January, 2017 to March, 2017 exclusively for the above businesses, and capitalized the same in its books of account as on 1st April, 2017. The cost of land included in the above figures are Rs.50 lakh, Rs.40 lakh and Rs.30 lakh, respectively. Further, during the P.Y.2017-18, he incurred capital expenditure of Rs.20 lakh, `15 lakh & Rs.10 lakh, respectively, for extension/ reconstruction of the building purchased and used exclusively for the above businesses.

The profits from the business of setting up a warehousing facility for storage of food grains, sugar and edible oil (before claiming deduction under section 35AD and section 32) for the A.Y. 2018 -19 is Rs.16 lakhs, Rs.14 lakhs and Rs.31 lakhs, respectively.

Compute the income under the head "Profits and gains of business or profession" for the A.Y.2018-19 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". Assume that expenditure incurred during the previous year 2017-18 are by account payee cheque or use of ECS through bank account.

Solution

Computation of profits and gains of business or profession for A.Y. 2018-19

Particulars	Rs.(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 Rs.30 lakh, being (Rs.50 lakh – Rs.30 lakh + Rs.10 lakh)	3
Income chargeable under "Profits and gains from business or profession"	**28**

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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 1.4.2017 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2017(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.2017-18	20	15	35
(D) **Total capital expenditure (B + C)**	**50**	**35**	**85**
(E) Deduction under section 35AD			
100% of capital expenditure	50	35	85
Total deduction u/s 35AD for A.Y.2018-19	**50**	**35**	**85**
(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)	**(34)**	**(21)**	**(55)**

Notes:

(i) Deduction of 100% of the capital expenditure is available under section 35AD for A.Y.2018-19 in respect of specified business of setting up and operating a warehousing facility for storage of sugar and setting up and operating a warehousing facility for storage of agricultural produce where operations are commenced on or after 01.04.2012.

(ii) 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.

(iii) 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. 2017-18.

(iv) Loss from a specified business can be set-off only against profits from another specified business. Therefore, the loss of Rs.55 lakh from the specified businesses of setting up and

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operating a warehousing facility for storage of food grains and sugar canno t be set-off against the profits of Rs.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.

Illustration 8

XYZ Ltd. commenced operations of the business of a new three -star hotel in Madurai, Tamil Nadu on 1.4.2017. The company incurred capital expenditure of Rs.50 lakh during the period January, 2017 to March, 2017 exclusively for the above business, and capitalized the same in his books of account as on 1st April, 2017. Further, during the P.Y. 2017-18, it incurred capital expenditure of Rs.2 crore (out of which Rs.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.2018-19, 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.2018-19 is Rs.25 lakhs. Assume that the company also have another existing business of running a four -star hotel in Coimbatore, which commenced operations ten years back, the profits from which are `120 lakhs for the A.Y.2018-19. Also, assume that expenditure incurred during the previous year 2017-18 are by account payee cheque or use of ECS through bank account.

Solution

Computation of profits and gains of business or profession for A.Y. 2018-19

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.2017-18(excluding the expenditure incurred on acquisition of land) = Rs.200 lakh – Rs.150 lakh	50 lakh	
Capital expenditure incurred prior to 1.4.2017(i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2017	50 lakh	
Total deduction under section 35AD for A.Y.2018-19		100 lakh
Loss from the specified business of new hotel in Madurai		**(75 lakh)**
Profit from the existing business of running a hotel in Coimbatore		120 lakh
Net profit from business after set-off of loss of specified business against profits of another specified business under section 73A		**45 lakh**

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DT QUESTION BANK BY YNB

Illustration 9

ABC Ltd. is a company having two units – Unit A carries on specified business of setting up and operating a warehousing facility for storage of sugar; Unit B carries on non -specified business of operating a warehousing facility for storage of edible oil.

Unit A commenced operations on 1.4.2016 and it claimed deduction of Rs.100 lacs incurred on purchase of two buildings for Rs.50 lacs each (for operating a warehousing facility for storage of sugar) under section 35AD for A.Y. 2017-18. However, in February, 2018, Unit A transferred one of its buildings to Unit B.

Examine the tax implications of such transfer in the hands of ABC Ltd.

Solution

Since the capital asset, in respect of which deduction of Rs. 50 lacs was claimed under section 35AD, has been transferred by Unit A carrying on specified business to Unit B carrying on non - specified business in the P.Y.2017-18, the deeming provision under section 35AD(7B) is attracted during the A.Y. 2018-19.

Particulars	`
Deduction allowed under section 35AD for A.Y.2017-18	50,00,000
Less: Depreciation allowable u/s 32 for A.Y.2017-18 [10% of Rs.50 lacs]	5,00,000
Deemed income under section 35AD(7B)	**45,00,000**

ABC Ltd., however, by virtue of proviso to Explanation 13 to section 43(1), can claim depreciation under section 32 on the building in Unit B. For the purpose of claiming depreciation on building in Unit B, the actual cost of the building would be:

Particulars	`
Actual cost to the assessee	50,00,000
Less: Depreciation allowable u/s 32 for A.Y.2017-18 [10% of Rs.50 lacs]	5,00,000
Actual cost in the hands of ABC Ltd. in respect of building in its Unit B	**45,00,000**

Illustration 10

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 und er section 36(1)(iva), if the basic salary of the employees aggregate to Rs.10 lakh. Would disallowance under section 40A(9) be attracted, and if so, to what extent?

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Solution

Computation of deduction u/s 36(1)(iva) and disallowance u/s 40A(9)

Particulars	`
Basic Salary	10,00,000
Dearness Allowance@40% of basic salary [DA forms part of pay]	4,00,000
Salary for the purpose of section 36(1)(iva) (Basic Salary + DA)	**14,00,000**
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 Rs.14,00,000 = ` 1,40,000)	**1,40,000**
Excess contribution disallowed under section 40A(9)	60,000

Illustration 11

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.2017-18*	*100*
(ii)	*Gross Total Income of A.Y.2018-19 [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 2017-18*	*210*

Compute the deduction allowable under section 36(1)(vii) for the A.Y.2018 -19.

Solution

Particulars		Rs.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 31.3.2018			
(i)	Provision for bad and doubtful debts u/s 36(1)(viia) upto A.Y.2017-18	100	
(ii)	Current year provision for bad and doubtful debts u/s 36(1)(viia) [8.5% of Rs.800 lakhs + 10% of Rs.300 lakhs]	98	198
Deduction under section 36(1)(vii) in respect of bad debts written off for A.Y.2018-19			**12**

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Illustration 12

Isac limited is a company engaged in the business of biotechnology. The net profit of the company for the financial year ended 31.03.2018 is Rs.35,25,890 after debiting the following items:

S.No.	Particulars	`
1.	Purchase price of raw material used for the purpose of in-house research and development	11,80,000
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	25,50,000
4.	Expenditure on notified skill development project:	
	(1) Purchase of land	40,00,000
	(2) Expenditure on training for skill development	32,50,000
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.2018-19 of Isac Ltd.

Solution

Computation of income under the head "Profits and gains of business or profession" for the A.Y.2018-19

Particulars		`	`
Net profit as per profit and loss account			35,25,890
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	

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	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)	25,50,000	
	Expenditure incurred on notified skill development project - Purchase of land - being capital expenditure not qualifying for deduction under section 35CCD	40,00,000	
	Expenditure incurred on notified skill development project - Expenditure on training for skill development (to be treated separately)	32,50,000	
	Expenditure incurred on advertisement in the souvenir published by a political party not allowed as deduction as per section 37(2B)	75,000	1,03,75,000
			1,39,00,890
Less:	Purchase price of raw material used for in-house research and development qualifies for 150% deduction under section 35(2AB). Since, it is already debited to profit and loss account balance 50% is allowed.	5,90,000	
Less:	Expenditure incurred on notified agricultural extension project qualifies for 150% deduction under section 35CCC.	38,25,000	
Less:	Expenditure incurred on training for skill development in a notified skill development project qualifies for 150% deduction under section 35CCD.	48,75,000	92,90,000
	Profit and gains from business		**46,10,890**

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.

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Illustration 13

Delta Ltd. credited the following amounts to the account of resident payees in the month of March, 2018 without deduction of tax at source. What would be the consequence of non -deduction of tax at source by Delta Ltd. on these amounts during the financial year 2017-18, assuming that the resident payees in all the cases mentioned below, have not paid the tax, if any, which was required to be deducted by Delta Ltd.?

	Particulars	Amount (`)
(1)	Salary to its employees (credited and paid in March, 2018)	12,00,000
(2)	Directors' remuneration (credited in March, 2018 and paid in April, 2018)	28,000

Would your answer change if Delta Ltd. has deducted tax on directors' remuneration in April, 2018 at the time of payment and remitted the same in July, 2018?

Solution

Non-deduction of tax at source on any sum payable to a resident on which tax is deductible at source as per the provisions of Chapter XVII-B would attract disallowance under section 40(a)(ia).

Therefore, non-deduction of tax at source on any sum paid by way of salary on which tax is deductible under section 192 or any sum credited or paid by way of directors' remuneration on which tax is deductible under section 194J, would attract disallowance@30% under section 40(a)(ia). Whereas in case of salary, tax has to be deducted under section 192 at the time of payment, in case of directors' remuneration, tax has to be deducted at the time of credit of such sum to the account of the payee or at the time of payment, whichever is earlier. Therefore, in b oth the cases i.e., salary and directors' remuneration, tax is deductible in the P.Y.2017 -18, since salary was paid in that year and directors' remuneration was credited in that year. Therefore, the amount to be disallowed under section 40(a)(ia) while computing business income for A.Y.2018-19 is as follows –

	Particulars	Amount paid in `	Disallowance u/s 40(a)(ia) @ 30% in `
(1)	Salary [tax is deductible under section 192]	12,00,000	3,60,000
(2)	Directors' remuneration [tax is deductible under section 194J without any threshold limit]	28,000	8,400
Disallowance under section 40(a)(ia)			**3,68,400**

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If the tax is deducted on directors' remuneration in the next year i.e., P.Y.2018 -19 at the time of payment and remitted to the Government, the amount of Rs.8,400 would be allowed as deduction while computing the business income of A.Y.2019-20.

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 pay ment 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, 30% of such 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. However, 30% of 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.

Illustration 14

During the financial year 2017-18, the following payments/expenditure were made/incurred by Mr. Yuvan Raja, a resident individual (whose turnover during the year ended 31.3.2017 was Rs.99 lacs):

(i) Interest of Rs.12,000 was paid to Rehman & Co., a resident partnership firm, without deduction of tax at source;

(ii) Rs.3,00,000 was paid as salary to a resident individual without deduction of tax at source;

(iii) Commission of Rs.16,000 was paid to Mr. Vidyasagar on 2.7.2017 without deduction of tax at source.

Briefly discuss whether any disallowance arises under the provisions of section 40(a)(ia) of the Income-tax Act, 1961.

Solution

Disallowance under section 40(a)(ia) of the Income-tax Act, 1961 is attracted where the assessee fails to deduct tax at source as is required under the Act, or having deducted tax at source, fails to remit the same to the credit of the Central Government within the stipulated time limit.

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(i) The obligation to deduct tax at source from interest paid to a resident arises under section 194A in the case of an individual, whose total turnover in the immediately preceding previous year, i.e., P.Y.2016-17 exceeds Rs.100 lakhs. Thus, in present case, since the turnover of the assessee is less than Rs.100 lakhs, he is not liable to deduct tax at source. Hence, disallowance under section 40(a)(ia) is not attracted in this case.

(iii) The disallowance of 30% of the sums payable under section 40(a)(ia) would be attracted in respect of all sums on which tax is deductible under Chapter XVII -B. Section 192, which

requires deduction of tax at source from salary paid, is covered under Chapter XVII-B. The obligation to deduct tax at source under section 192 arises, in the hands all assessee - employer even if the turnover amount does not exceed `100 lacs in the immediately preceding previous year.

Therefore, in the present case, the disallowance under section 40(a)(ia) is attracted for failure to deduct tax at source under section 192 from salary payment. However, only 30% of the amount of salary paid without deduction of tax at source would be disallowed.

(iv) The obligation to deduct tax at source under section 194-H from commission paid in excess of Rs.15,000 to a resident arises in the case of an individual, whose total turnover in the immediately preceding previous year, i.e., P.Y.2016-17 exceeds Rs. 100 lakhs. Thus, in present case, since the turnover of the assessee is less than Rs.100 lakhs, he is not liable to deduct tax at source. Therefore, disallowance under section 40(a)(ia) is not attracted in this case.

Illustration 15

A firm has paid Rs.7,50,000 as remuneration to its partners for the P.Y.2017-18, in accordance with its partnership deed, and it has a book profit of Rs.10 lakh. What is the remuneration allowable as deduction?

Solution

The allowable remuneration calculated as per the limits specified in section 40(b)(v) would be –

Particulars	`
On first Rs.3 lakh of book profit [Rs.3,00,000 × 90%]	2,70,000
On balance Rs.7 lakh of book profit [Rs.7,00,000 × 60%]	4,20,000
	6,90,000

The excess amount of Rs.60,000 (i.e., Rs.7,50,000 – Rs.6,90,000) would be disallowed as per section 40(b)(v).

Illustration 16

Rao & Jain, a partnership firm consisting of two partners, reports a net profit of Rs.7,00,000 before deduction of the following items:

(1) Salary of Rs.20,000 each per month payable to two working partners of the firm (as authorized by the deed of partnership).

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(2) Depreciation on plant and machinery under section 32 (computed) Rs.1,50,000.

(3) Interest on capital at 15% per annum (as per the deed of partnership). The amount of capital eligible for interest Rs.5,00,000.

Compute:

(i) Book-profit of the firm under section 40(b) of the Income-tax Act, 1961.

(ii) Allowable working partner salary for the assessment year 2018-19 as per section 40(b).

Solution

(i) As per Explanation 3 to section 40(b), "book profit" shall mean the net profit as per the profit and loss account for the relevant previous year computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to the partners of the firm if the same has been already deducted while computing the net profit.

In the present case, the net profit given is before deduction of depreciation on plant and machinery, interest on capital of partners and salary to the working partners. Therefore, the book profit shall be as follows:

Computation of Book Profit of the firm under section 40(b)

Particulars		`	`
Net Profit (before deduction of depreciation, salary and interest)			7,00,000
Less:	Depreciation under section 32	1,50,000	
	Interest @ 12% p.a. [being the maximum allowable as per section 40(b)] (Rs.5,00,000 × 12%)	60,000	2,10,000
Book Profit			**4,90,000**

(ii) Salary actually paid to working partners = Rs.20,000 × 2 × 12 = Rs.4,80,000.

As per the provisions of section 40(b)(v), the salary paid to the working partners is allowed subject to the following limits -

On the first Rs.3,00,000 of book profit or in case of loss	Rs.1,50,000 or 90% of book profit, whichever is more
On the balance of book profit	60% of the balance book profit

Therefore, the maximum allowable working partners' salary for the A.Y. 2018-19 in this case would be:

Particulars	`
On the first Rs.3,00,000 of book profit [(Rs.1,50,000 or 90% of Rs.3,00,000) whichever is more]	2,70,000

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On the balance of book profit [60% of (Rs.4,90,000 - Rs.3,00,000)]	1,14,000
Maximum allowable partners' salary	**3,84,000**

Hence, allowable working partners' salary for the A.Y. 2018-19 as per the provisions of section 40(b)(v) is Rs.3,84,000.

Illustration 17

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 (APSFC) and Indian Bank and has not paid interest as detailed hereunder:

		`
(i)	Andhra Pradesh State Financial Corporation (P.Y. 2016-17 & 2017-18)	15,00,000
(ii)	Indian Bank (P.Y. 2017-18)	30,00,000
		45,00,000

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Both APSFC and Indian Bank, while restructuring the loan facilities of Hari during the year 2017 - 18, converted the above interest payable by Hari to them as a loan repayable in 60 equal installments. During the year ended 31.3.2018, Hari paid 5 installments to APSFC and 3 installments to Indian Bank.

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

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 met hod of accounting followed by the assessee. Where there is default in the payment of interest by the assessee, such unpaid interest may be converted into loan. Such conversion of unpaid interest into loan shall not be construed as payment of interest for the purpose of section 43B. The amount of unpaid interest so converted as loan shall be allowed as deduction only in the year in which the converted loan is actually paid.

In the given case of Hari, the unpaid interest of Rs.15,00,000 due to APSFC and of Rs.30,00,000 due to Indian Bank was converted into loan. Such conversion would not amount to payment of interest and would not, therefore, be eligible for deduction in the year of such conversion. Hence, claim of Hari that the entire interest of Rs.45,00,000 is to be allowed as deduction in the year of conversion is not tenable. The deduction shall be allowed only to the extent of repayment made during the financial year. Accordingly, the amount of interest eligible for deduction for the A.Y.201 8-19shall 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**

Illustration 18

Vinod is a person carrying on profession as film artist. His gross receipts from profession are as under:

	`
Financial year 2014-15	1,15,000
Financial year 2015-16	1,80,000
Financial year 2016-17	2,10,000

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What is his obligation regarding maintenance of books of accounts for Assessment Year 2018 -19 under section 44AA of Income-tax Act, 1961?

Solution

Section 44AA(1) requires every person carrying on any profession, notified by the Board in the Official Gazette (in addition to the professions already specified therein), to maintain such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance with the provisions of the Income-tax Act, 1961.

A person carrying on a notified profession shall be required to maintain **specified books of accounts, only if**:

(i) his gross receipts in all the three years immediately preceding the relevant previous year has exceeded Rs.1,50,000; or

(ii) it is a new profession which is setup in the relevant previous year, it is likely to exceed Rs.1,50,000 in that previous year.

In the present case, Vinod is a person carrying on profession as film artist, which is a notified profession. Since his gross receipts have not exceeded Rs.1,50,000 in financial year 2014-15, the requirement under section 44AA to compulsorily maintain the prescribed books of account is not applicable to him.

Mr. Vinod, however, required to maintain such books of accounts as would enable the Assessing Officer to compute his total income.

Illustration 19

Mr. Praveen engaged in retail trade, reports a turnover of `1,98,50,000 for the financial year 2017-18. His income from the said business as per books of account is computed at Rs.13,20,000. Retail trade is the only source of income for Mr. Praveen.

(i) Is Mr. Praveen eligible to opt for presumptive taxation scheme in respect of his income from retail trade for the assessment year 2018-19?

(ii) If so, determine his income from retail trade as per the applicable presumptive provision.

(iii) In case Mr. Praveen does not opt for presumptive taxation of income from retail trade, what are his obligations under the Income-tax Act, 1961?

(iv) What is the due date for filing his return of income under both the options?

Solution:

(i) Yes. Since his total turnover for the F.Y .2017-18 is below Rs.200 lakhs, he is eligible to opt for presumptive taxation scheme under section 44AD in respect of his retail trade business.

(ii) His income from retail trade, applying the presumptive tax provisions under section 44AD, would be Rs.15,88,000, being 8% of Rs.1,98,50,000.

Alternative view: It can be assumed that Mr. Praveen has received whole of the amount of turnover by cheque or bank draft or use of electronic clearing system. In that case, his

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income from retail trade, applying the presumptive tax provisions u nder section 44AD, would be Rs.11,91,000, being 6% of Rs.1,98,50,000.

(iii) Section 44AB makes it obligatory for every person carrying on business to get his accounts of any previous year audited if his total sales, turnover or gross receipts exceed Rs.1 crore. However, if an eligible person opts for presumptive taxation scheme as per section 44AD(1), he shall not be required to get his accounts audited if the total turnover or gross receipts of the relevant previous year does not exceed Rs.2 crore.

In this case, if Mr. Praveen does not opt for the presumptive taxation scheme under section 44AD, he has to get his books of accounts audited and furnish a report of such audit under section 44AB, since his turnover exceeds Rs.1 crore during the P.Y.2017-18.

(iv) In case he opts for the presumptive taxation scheme under section 44AD, the due date would be 31st July, 2018.

In case he does not opt for the presumptive taxation scheme, he is required to get his books of account audited, in which case the due date for filing of return would be 30th September, 2018.

Illustration 20

An assessee owns a light commercial vehicle for 9 months 15 days, a medium goo ds 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 Rs.7,500 × 10 + Rs.7,500 × 9 + Rs.7,500 × 12 = Rs.2,32,500.

Illustration 21

Mr. X commenced the business of operating goods vehicles on 1.4.2017. He purchased the following vehicles during the P.Y.2017-18. Compute his income under section 44AE for A.Y. 2018-19.

	Type of Vehicle	*Number*	*Date of purchase*
(1)	*Light Goods Vehicles*	*2*	*10.4.2017*
		1	*15.3.2018*
(2)	*Medium Goods Vehicles*	*3*	*16.7.2017*
		1	*2.1.2018*
(3)	*Heavy Goods Vehicles*	*2*	*29.8.2017*
		1	*23.2.2018*

Would your answer change if the two light goods vehicles purchased in April, 2017 were put to use only in July, 2017?

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Solution

Since Mr. X does not own more than 10 vehicles at any time during the previous year 201 7-18, he is eligible to opt for presumptive taxation scheme under section 44AE. Rs.7,500 per month or part of month for which each goods carriage is owned by him would be deemed as his profits and gains from such goods carriage.

(1)	(2)	(3)	(4)
Number of Vehicles	**Date of purchase**	**No. of months for which vehicle is owned**	**No. of months × No. of vehicles [(1) × (3)]**
2	10.4.2017	12	24
1	15.3.2018	1	1
3	16.7.2017	9	27
1	2.1.2018	3	3
2	29.8.2017	8	16
1	23.2.2018	2	2
10		**Total**	**73**

Therefore, presumptive income of Mr. X under section 44AE for A.Y.2018-19 is Rs.5,47,500, being 73 × Rs.7,500.

The answer would remain the same even if the two vehicles purchased in April, 2017 were put to use only in July, 2017, since the presumptive income of Rs.7,500 per month has to be calculated per month or part of the month for which the vehicle is owned by Mr. X.

Illustration 22

Alpha Co-operative Bank amalgamated with Beta Co-operative Bank on 1.12.2017. The depreciation for the year ended 31.3.2018 calculated as per Income-tax Rules, 1962, allowable to Alpha Co-operative Bank had the amalgamation had not taken place amounts to Rs. 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. 2018-19.

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. I n this case, the amount of deduction is Rs.2,40,000.[127]

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B = the number of days comprised in the period beginning with the 1st day of the financial year (i.e., 1.4.2017, in this case) and ending on the day immediately preceding the date of business reorganization (i.e., 30.11.2017, 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 Rs.2,40,000.

B = the number of days comprised in the period beginning with the date of business reorganisation (i.e. 1.12.2017, in this case) and ending on the last day of the financial year (i.e. 31.3.2018); 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 Rs.2,40,000 and the business re-organisation took place on 1.12.2017. Therefore, the deduction allowable to Alpha co-operative bank under section 32 would be `1,60,438 i.e., Rs.2,40,000 x 244/365. The deduction allowable to Beta co-operative bank would be Rs.79,562 i.e., Rs.2,40,000 x 121/365.

Illustration 23

Miss Vivitha, a resident and ordinarily resident in India, has derived the following income from various operations (relating to plantations and estates owned by her) during the year ended 31 -3-2018:

S. No.	Particulars	`
(i)	Income from sale of centrifuged latex processed from rubber plants grown in Darjeeling.	3,00,000
(ii)	Income from sale of coffee grown and cured in Yercaud, Tamil Nadu.	1,00,000
(iii)	Income from sale of coffee grown, cured, roasted and grounded, in Colombo. Sale consideration was received at Chennai.	2,50,000
(iv)	Income from sale of tea grown and manufactured in Shimla.	4,00,000
(v)	Income from sapling and seedling grown in a nursery at Cochin. Basic operations were not carried out by her on land.	80,000

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You are required to compute the business income and agricultural income of Miss Vivitha for the assessment year 2018-19.

Solution

Computation of business income and agricultural income of Ms. Vivitha for the A.Y.2018 -19

Sr. No.	Source of income	Gross (Rs.)	Business income		Agricultural income
			%	`	`
(i)	Sale of centrifuged latex from rubber plants grown in India.	3,00,000	35%	1,05,000	**1,95,000**
(ii)	Sale of coffee grown and cured in India.	1,00,000	25%	25,000	**75,000**
(iii)	Sale of coffee grown, cured, roasted and grounded outside India. **(See Note 1 below)**	2,50,000	100%	2,50,000	**-**
(iv)	Sale of tea grown and manufactured in India	4,00,000	40%	1,60,000	**2,40,000**
(v)	Saplings and seedlings grown in nursery in India **(See Note 2 below)**	80,000		Nil	**80,000**
	Total			**5,40,000**	**5,90,000**

Notes:

1. Where income is derived from sale of coffee grown, cured, roasted and grounded by the seller in India, 40% of such income is taken as business income and the balance as agricultural income. However, in this question, these operations are done in Colombo, Sri lanka. Hence, there is no question of such apportionment and the whole income is taxable as business income. Receipt of sale proceeds in India does not make this agr icultural income. In the case of an assessee, being a resident and ordinarily resident, the income arising outside India is also chargeable to tax.

2. 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.

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EXERCISE

Question 1

Examine critically the following cases in the context of provisions contained in the Income-tax Act, 1961 relevant for Assessment Year 2018-19. Support the answers with relevant case laws and workings.

(a) Mr. Janak is proprietor of M/s. Yash Texnit which is engaged in garment manufacturing business. The entire block of Plant & Machinery chargeable to depreciation @ 15%, has 20 different machinery items as at 31-03-2018. One of the machineries used for packing had become obsolete and was discarded by Mr. Janak in July' 17.

Assessee filed its return for A.Y. 2018-19 claiming total depreciation of Rs. 40 lacs which includes Rs. 4 lacs being the depreciation claimed on the machinery item discarded by Mr. Janak. The A.O. disallowed the claim of depreciation of Rs.4 lacs during the course of scrutiny assessment.

Comment on the validity of action taken by A.O.

(b) X. Ltd. issued debentures in the previous year 2017-18, which were to be matured at the end of 5 years. The debenture holder was given an option of one time upfront payment of Rs.60 per debenture on account of interest which was to be immediately paid by the company. As per the option exercised by the debenture holders, company paid interest upfront to them in the first year itself and the same was claimed as deduction in the retu rn of the company. But in the accounts, the interest expenditure was shown as deferred expenditure to be written off over a period of 5 years. During the course of assessment, the Assessing Officer spread the upfront interest paid over a period of five year term of debentures and allowed only one-fifth of the amount in the previous year 2017-18. Examine the correctness of the action of Assessing Officer.

Answer

(a) The issue under consideration is whether disallowance of depreciation made by the Assessing Officer with regard to the discarded asset, in arriving at the written down value of the block of assets, is justified.

One of the conditions for claim of depreciation under section 32 is that the eligible asset must have been put to use for the purpose of business or profession.

The other aspect to considered is whether merely discarding an obsolete machinery, which is physically available, will attract the expression "moneys payable" appearing in section 43(6), so as to deduct its value from the written down value of the block.

The facts in the present case are similar to facts in the case of CIT v. Yamaha Motor India Pvt. Ltd. (2010) 328 ITR 297, wherein the Delhi High Court observed that the expression

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"used for the purposes of the business" in section 32 when used with respect to discarded machinery would mean the use in the business, not only in the relevant financial year/previous year, but also in the earlier financial years.

The discarded machinery may not be actually used in the relevant previous ye ar but depreciation can be claimed as long as it was used for the purposes of business in the earlier years provided the block continues to exist in the relevant previous year. Therefore, the condition for claiming depreciation in respect of the discarded machine would be satisfied if it was used in the earlier previous years for the business.

For the purpose of section 43(6), "moneys payable" means the sale price, in case of sale, or the insurance, salvage or compensation moneys payable in respect of the a sset. In this case, the machinery has not been sold as machinery or scrap or disposed off, and it continues to exist. Hence, there is no "moneys payable" in this case, which alone is deductible while computing the WDV of the block to which it belongs.

Applying the rationale of the above case, the action of the Assessing Officer in disallowing Rs. 4 lakhs, being the depreciation claim attributable to discarded machinery, on the ground that the same was not put to use in the relevant previous year, is invalid, since the said machinery was put to use in the earlier previous years.

(b) The issue under consideration is whether, in a case where debentures are issued with maturity at the end of five years, and the debenture holders are given an option of upfront payment of interest in the first year itself, can the entire upfront interest paid, be claimed as deduction by the company in the first year or should the same be deferred over a period of five years; and would the treatment of such interest as deferred r evenue expenditure in the books of account have any impact on the tax treatment.

The facts of the case are similar to the facts in Taparia Tools Ltd. v. JCIT (2015) 372 ITR 605, wherein the above issue came up before the Supreme Court. In that case, it was observed that under section 36(1)(iii), the amount of interest paid in respect of capital borrowed for the purposes of business or profession, is allowable as deduction.

The moment the option for upfront payment was exercised by the subscriber, the liabi lity of X Ltd. to make the payment in that year had arisen. Not only had the liability arisen in the previous year in question, it was even quantified and discharged as well in that very year.

As per the rationale of the Supreme Court ruling in Taparia Tools Ltd.'s case, when the deduction of entire upfront payment of interest is allowable as per the Income -tax Act, 1961, the fact that a different treatment was given in the books of account could not be a factor which would bar the company from claiming the entire expenditure as a deduction.

Accordingly, the action of the Assessing Officer in spreading the upfront interest paid over the five year term of debentures and restricting the deduction in the P.Y.2017-18 to one-fifth of the upfront interest paid is **not** correct. The company is eligible to claim the entire amount of interest paid upfront as deduction under section 36(1)(iii) in the P.Y.2017-18.

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Question 2

Compute the quantum of depreciation available under section 32 of the Income -tax Act, 1961 in respect of the following items of Plant and Machinery purchased by PQR Textile Ltd., by paying through account payee cheque, which is engaged in the manufacture of textile fabrics, for the year ended 31-3-2018:

	(Rs. In crores)
New machinery installed on 1-5-2017	84
New Windmill purchased and installed on 18-6-2017.	22
Items purchased after 30th November 2017:	
Lorries for transporting goods to sales depots	3
Fork-lift-trucks, used inside factory	4
Computers installed in office premises	1
Computers installed in factory	2
New imported machinery	12

The new imported machinery arrived at Chennai port on 30-03-2018 and was installed on 3-4-2018. All other items were installed during the year ended 31-3-2018.

The company was newly started during the year.

Also, compute the WDV of the various blocks of assets as on 1.4.2018.

Answer

Computation of depreciation allowance under section 32 for the A.Y. 201 8-19

Particulars	Normal Depreciation [u/s 32(1)(ii)]	Additional Depreciation [u/s 32(1)(iia)]
	(Rs. in crores)	
(A) Plant and Machinery (15% block) (Put to use for 180 days or more)		
- New machinery installed on 01.05.2017	84.00	84.00
Normal Depreciation @15% & additional deprecation @20%	**12.60**	**16.80**
(B) Plant and Machinery (15% block) (Put to use for less than 180 days – hence, depreciation is restricted to 7.5%, being 50% of 15%)		
- Lorries for transporting goods to depots	3.00	-

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- Fork-lift trucks, used inside a factory	4.00	4.00
	7.00	4.00
Normal Depreciation @ 7.5% & additional depreciation @10%	**0.53**	**0.40**
(C) Plant and Machinery (40% block) (Put to use for less than 180 days, hence depreciation restricted to 30%, i.e., 50% of 40%)		
- Computers installed in office premises	1.00	**-**
- Computers installed in factory	2.00	**2.00**
	3.00	**2.00**
Normal depreciation @20% & additional depreciation @10%	0.60	**0.20**
(D) Plant and Machinery (40% block) (Put to use for 180 days or more) (See Note 1)		
- New windmill purchased and installed on 18.06.2017	22.00	22.00
Normal Depreciation @ 40% & additional depreciation @ 20%	**8.80**	**4.40**
Total depreciation and additional depreciation		
- Plant and Machinery (15% block) (A +B)	13.13	17.20
- Plant and Machinery (40% block) (C + D)	9.40	4.60
Depreciation available under section 32 = `44.33 crores		

Computation of Written Down Value (WDV) as on 01.04.2018

Particulars	Plant & Machinery	
	15%	40%
	(Rs. in crores)	
WDV as on 01.04.2017 (The company was started during the year – as given in question)	Nil	Nil
Add: Plant and Machinery acquired during the year		
- New Machinery installed on 01.05.2017 84.00		

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- Lorries for transporting goods to sales depots	3.00		
- Fork-lift trucks, used inside factory	4.00		
- New imported machinery	12.00	103.00	-
- New Windmill purchased and installed on 18.6. 2017		-	22.00
- Computers installed in office premises		-	1.00
- Computers installed in factory		-	2.00
		103.00	**25.00**
Less: Asset sold during the year		Nil	Nil
WDV as on 31.3.2018 (before charging depreciation)		**103.00**	**25.00**
Less: Depreciation for the P.Y.2017-18			
- Normal depreciation		13.13	9.40
- Additional depreciation		17.20	4.60
WDV as on 1.4.2018		**72.67**	**11.00**

Notes:

(1) Windmills and any specially designed devices which run on windmills installed on or after 1.4.2014 would be eligible for depreciation @ 40%.

(2) New imported machinery was not installed during the previous year 2017-18. Hence, it would not be eligible for additional depreciation for A.Y. 2018-19. It would also not be eligible for normal depreciation for A.Y 2018-19, since it was not put to use in the P.Y.2017-18 being the year of acquisition.

(3) It may be noted that investment in the following plant and machinery would not be eligible for additional depreciation under section 32(1)(iia):

(a) Lorries for transporting goods to sales depots, being vehicles/road transport vehicles; and Computers installed in office premises.

(4) As per section 2(28) of the Motor Vehicles Act, 1988, the definition of a "vehicle" excludes, inter alia, a vehicle of special type adopted for use only in a factory or in any enclosed premises. Therefore, fork-lift trucks used inside the factory would not fall within the definition of "vehicle". Hence, it is eligible for additional deprecation under section 32(1)(iia).

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***Note**–The above solution has been worked out assuming that PQR Textiles Ltd. has not exercised the option to be taxed at a concessional rate of 25% under section 115BA. If the company has exercised this option, then, it would not be eligible for additional depreciation.*

Question 3

(A) Examine the taxability and/or allowability of the following receipts or expenditures under the provisions of the Income-tax Act, 1961, for the assessment year 2018-19:

(i) S Ltd. receives a sum of Rs.10 lakhs from K Ltd. on 3rd January, 2018 for agreeing not to carry on any business relating to computer software in India for the next three years.

(ii) Secret commission was paid during the previous year 2017-18.

(iii) P Ltd. paid dollars equivalent to Rs.50 lakhs as sales commission for the year ended 31.03.2018, without deducting tax at source, to Mr. Rodrigues , a citizen of UK and non-resident who acted as agent for booking orders, from various customers who are outside India.

(B) Can the following transactions be covered under section 43B for disallowance?

(i) A bank guarantee given by a company towards disputed tax liabilities.

(ii) Interest payable to Goods and Services Tax Department but not paid before the due date specified in section 139(1).

Answer

(A) (i) As per section 28(va), any sum received under an agreement for not carrying out any activity in relation to any business / profession (i.e., non-compete fee) is chargeable to income-tax under the head "Profits and gains of business or profession".

Accordingly, Rs.10 lakhs received by S Ltd. from K Ltd. for agreeing not to carry on any business relating to computer software in India for the next three years is chargeable to income-tax under the head "Profits and gains of business or profession".

The amount shall be allowed as deduction in the hands of K Ltd. provided tax has been deducted at source under section 194J on the payment so made to S Ltd. If tax is not deducted at source, 30% of the expenditure shall be disallowed under section 40(a)(ia).

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

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

(iii) A foreign agent of an Indian exporter operates in his own country and no part of his income accrues or arises in India. His commission is usually remitted directly to him and

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is, therefore, not received by him or on his behalf in India. The commission paid to the non-resident agent for services rendered outside India is, thus, not chargeable to tax in India.

Since commission income for booking orders by non-resident who remains outside India is not subject to tax in India, disallowance under section 40(a)(i) is not attracted in respect of payment of commission to such non-resident outside India even though tax has not been deducted at source. Thus, the amount of Rs.50 lakhs remitted to Mr. Rodrigues outside India in foreign currency towards commission would not attract disallowance under section 40(a)(i) for non-deduction of tax at source.

(B) (i) For claiming deduction of any expense enumerated under section 43B, t he requirement is, the actual payment and not deemed payment. Furnishing of bank guarantee cannot be equated with actual payment. Actual payment requires that money must flow from

the assessee to the public exchequer as specified in section 43B. Therefore, deduction of an expense covered under section 43B cannot be claimed by merely furnishing a bank guarantee [CIT v. McDowell & Co Ltd (2009) 314 ITR 167 (SC)]

(ii) Interest payable to Goods and Services Tax department is part of Goods and Services Tax.

Therefore, interest payable to Goods and Services Tax department, which is not paid before the "due date" of filing of return of income, would attract disallowance under section 43B [Mewar Motors v. CIT (2003) 260 ITR 218 (Raj)]

Question 4

ILT Limited is engaged in manufacturing pipes and tubes. The profit and loss account of the company for the year ended 31st March, 2018 shows a net profit of Rs.405 lacs. The following information and particulars are furnished to you. You are required to compute total income of the company for Assessment Year 2018-19 indicating reasons for treatment of each item.

(i) A group free air ticket was provided by a supplier for reaching a certain volume of purchase during the financial year 2017-18. The same is encashed by the company for Rs.10 lacs in April 2018 and credited to General Reserve Account.

(ii) A regular supplier of raw materials agreed for settlement of Rs.8 lacs instead of Rs.10 lacs for poor quality of material supplied during the previous year which was not given effec t in the running account of the supplier.

(iii) Andhra Bank sanctioned and disbursed a term loan in the financial year 2014-15 for a sum of Rs.50 lacs. Interest of Rs.8 lacs was in arrear. The bank has converted the arrear interest into a new loan repayable in 10 equal instalments. During the year, the company has paid 2 instalments and the amount so paid has been reduced from Funded Interest in the Balance Sheet.

(iv) The company remitted Rs.5 lacs as interest to a company incorporated in USA on a loan taken 2 years ago. Tax deducted under section 195 from such interest has been deposited by the company on 15th July, 2018. The said interest was debited to profit and loss account.

(v) Sandeep, a sales executive stationed at HO at Delhi, was on official tour in Bangalore from 31st May,2017 to 18th June, 2017 and 28th September, 2017 to 15th October, 2017 for the business

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development. The company has paid Sandeep's salary in cash, from its local office at Bangalore for the month of May, 2017 (payable on 1st June) and September 2017 (payable on 1st October), amounting to Rs.45,000 and Rs.47,000 respectively (net of TDS and other deduction), as Sandeep has no bank account at Bangalore. These were included in the amount of "salary" debited to Profit and Loss Account.

(vi) The company has contributed Rs.50,000 by cheque to an electoral trust and the same stands included under the head "General Expenses".

Answer

Computation of total income of ILT Ltd. for the A.Y.2018-19

Particulars	Rs.(in lacs)	
Profits and gains from business or profession		
Net profit as per profit and loss account		405.00
Add : Items debited to profit and loss account, but to be disallowed and items not considered in accounts but to be taxed		
Value of group free air ticket provided by a supplier is taxable as business income under section 28(iv), as the value of any benefit, whether convertible into money or not, arising from business is taxable as business income.	10	
Amount waived by the supplier of raw materials is a deemed income under section 41(1), as the expenditure was allowed as deduction in the last year and there is a benefit by way of remission or cessation of a trading liability. The fact that effect was not given in the running account of supplier is not relevant.	2	
Interest payable outside India to a foreign company is allowable **(See Note 1 below)**	-	
Contribution to electoral trust is not an allowable expenditure while computing business income. Hence, the same has to be added back, since it is included in general expenses.	0.50	
Salary paid to employee Sandeep is eligible for deduction. Disallow ance under section 40A(3) will not apply **[See Note 2 below]**	NIL	12.50
		417.50
Less: Amount of deduction allowable		

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Under section 43B, interest on loan due to any scheduled bank, etc. is allowed as deduction, if such interest is actually paid irrespective of the method of accounting followed by the assessee. Conversion of arrear interest into a fresh loan by a bank cannot be considered as actual payment of interest. However, the amount of funded interest (i.e.,		
converted loan) actually paid is allowable as deduction. Hence, Rs.1,60,000, being two installments of Rs.80,000 each, actually paid is deductible.		1.60
Business Income		**415.90**
Gross total income		**415.90**
Less: Deduction under Chapter VI-A		
Deduction under section 80GGB in respect of contribution by the assessee company to an electoral trust.		0.50
Total Income		**415.40**

Notes:

1. Since tax has been deducted on interest payable outside India to a foreign company during the previous year 2017-18 and the same has been deposited before the due date of filing return of income under section 139(1), disallowance under section 40(a)(i) is not attracted. Since the interest has already been debited to profit and loss account, no further adjustment is required.

2. In respect of payment of salary to sales executive in cash, no disallowance under section 40A(3) is to be made as the payments fall within the scope of Rule 6DD(i). Salary paid to him in cash is allowable as the executive was temporarily posted for a continuous period of more than 15 days in Bangalore which is not the place of his normal duty. Further tax was deducted from such salary under section 192 and he does not maintain any bank account in Bangalore. No disallowance under section 40A(3) is attracted in respect of such salary.

Question 5

G Ltd. is engaged in the business of growing and manufacturing tea in India. For the previous year ended 31.03.2017, its composite business profits before allowing deduction u/s 33AB is Rs.60,00,000. On 01.09.2017, it deposited a sum of Rs.11,00,000 in the Tea Development Account. During the previous year 2015-16, G Ltd. had incurred a business loss of Rs.14,00,000 which has been carried forward. On 25.01.2018, it withdrew Rs.10 lakhs, from deposit account which is utilized as under:

Rs.6,00,000 for purchase on non-depreciable asset as per the scheme specified.

Rs.3,00,000 for purchase of machinery to be installed in the office premises.

Rs.1,00,000 was spent for the purpose of scheme on 5.4.2018.

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DT QUESTION BANK BY YNB

(i) You are required to determine business income of G Ltd. and the tax consequences that may arise from the above transactions in the relevant assessment year.

(ii) What will be the consequence if the asset which was purchased for Rs.6,00,000 is sold for ` 8,00,000 in April, 2018.

Answer

(i) Computation of Business Income of G Ltd. for the A.Y. 2018-19

Particulars	`
Rs.10,00,000 being the amount withdrawn from Tea Development Account has to be utilized in the prescribed manner, otherwise, the withdrawn amount would be chargeable to tax as business income. In the given case, the taxability of withdrawal amount based on their utilization is as follows:	
- Rs.6,00,000, out of the amount withdrawn from the deposit account, utilised for purchase of non-depreciable asset as per the specified scheme. [As per section 33AB(6), no deduction would be allowed under section 33AB since amount is spent out of Rs.11 lakh deposited in Tea Development Account, which has already been allowed as deduction in A.Y.2017-18 **(See Working Note below)**].	Not taxable
- Rs.3,00,000, being the amount utilized for purchase of machinery to be installed in the office premises is not a permissible utilization. Hence, the amount would be deemed as profits and gains of business of the previous year 2017-18 as per section 33AB(4).	3,00,000
- Rs.1,00,000 was spent for the purpose of scheme on 05.04.2018. As per section 33AB(7), this amount would be taxable since the same is not utilized during the same previous year (i.e., P.Y. 2017-18) in which the amount is withdrawn from the deposit account.	1,00,000
The entire amount of Rs.10 lakh (forming part of Rs.11 lakh deposited in Tea Development Account) was deducted in the assessment year 2017-18 before segregation of agricultural and non-agricultural income **(See Working Note below)**. Therefore, when any part of such amount becomes taxable, the agricultural and non-agricultural portions of income must be segregated. Accordingly, Rs.1,60,000, being 40% of Rs.4,00,000 (Rs.3,00,000 + Rs.1,00,000) would be chargeable to tax as business income and the balance Rs.2,40,000, being 60% of Rs.4,00,000 would be agricultural income exempt from tax.	

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Working Note:

Computation of Business Income of G Ltd. for the A.Y. 2017-18

Particulars	`
Composite business profits before allowing deduction under section 33AB	60,00,000
Less: Deduction under section 33AB(1) would be the lower of: - Amount deposited in Tea Development Account on or before 30.9.2017 [i.e., Rs.11,00,000] - 40% of profits of such business [i.e., Rs.24,00,000, being 40% of Rs.60,00,000]	11,00,000
	49,00,000
Less: 60% of Rs.49,00,000, being agricultural income **[as per Rule 8]**	29,40,000
Business income	19,60,000
Less: Brought forward business loss of A.Y.2016-17 set-off as per section 72	14,00,000
Business income chargeable to tax	5,60,000

(ii) Consequences, if asset purchased out of deposit account is sold during the previous year 2018-19

As per section 33AB(8), if the asset is sold before the expiry of eight years from the end of the previous year in which it was acquired, then, the cost of such asset shall be deemed to be the profits and gains from business or profession of the previous year in which asset is sold.

Therefore, Rs.6,00,000 would be deemed to be the business income (composite) for the A.Y.2019-20. However, since the full cost of the asset was deducted in the assessment year 2017-18 (being part of Rs.11 lakh deposited in Tea Development Account) before segregation of agricultural income and non-agricultural income, the agricultural and non-agricultural portions of income should be segregated in the year in which such amo unt becomes taxable on account of sale of asset before the expiry of eight years. Therefore, Rs.3,60,000, being 60% of Rs.6,00,000 would represent agricultural income. The balance Rs.2,40,000 being 40% of Rs.6,00,000 would be chargeable to tax as business income.

Moreover, the difference between the sale consideration and purchase price of the asset would be chargeable to tax as "Short term capital gains", which is computed as follows:

Sales consideration	8,00,000
Less: Cost of acquisition	6,00,000
Short term capital gain	**2,00,000**

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Question 6

The trading and profit and loss account of Pingu Trading Pvt. Ltd. having business of agricultural produce, consumer items and other products for the year ended 31.03.2018 is as under:

Trading Account

Particulars	`	Particulars	`
Opening Stock	3,75,000	Sales	1,55,50,000
Purchases	1,25,75,000	Closing Stock	4,50,000
Freight & Cartage	1,26,000		
Gross profit	29,24,000		
	1,60,00,000		1,60,00,000

Profit and Loss Account

Particulars	`	Particulars	`
Bonus to staff	47,500	Gross profit	29,24,000
Rent of premises	53,500	Income-tax refund	20,000
Advertisement	5,000	Warehousing charges	15,00,000
Bad Debts	75,000		
Interest on loans	1,67,500		
Depreciation	71,500		
Goods and Services tax demand paid	1,08,350		
Miscellaneous expenses	5,25,650		
Net profit of the year	33,90,000		
	44,44,000		44,44,000

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

(i) There was a survey under section 133A on the business premises on 31.3.2018 in which it was revealed that the value of closing stocks of 31.3.2017 was Rs.8,75,000 and a sale of Rs.75,000 made on 13.3.2018 was not recorded in the books. The value of closing stocks after

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considering these facts and on the basis of inventory prepared by the department as on 31.3.2018 worked out at Rs.12,50,000, which was accepted to be correct and not disputed.

(ii) Income-tax refund includes amount of Rs.4,570 of interest allowed thereon.

(iii) Bonus to staff includes an amount of Rs.7,500 paid in the month of December 2017, which was provided in the books on 31.03.2017.

(iv) Rent of premises includes an amount of Rs.5,500 incurred on repairs. The assessee was under no obligation to incur such expenses as per rent agreement.

(v) Advertisement expenses include an amount of Rs.2,500 paid for advertisement published in the souvenir issued by a political party. The payment is made by way of an account payee cheque.

(vi) Miscellaneous expenses include:

(a) amount of Rs.15,000 paid towards penalty for non-fulfillment of delivery conditions of a contract of sale for the reasons beyond control,

(b) amount of Rs.1,00,000 paid to the wife of a director, who is working as junior lawyer for taking an opinion on a disputed matter. The junior advocate of High Courts normally charge only Rs.25,000 for the same opinion,

(c) amount of Rs.1,00,000 paid to an Electoral Trust by cheque.

(vii) Goods and Services Tax demand paid includes an amount of Rs.5,300 charged as penalty for delayed filing of returns and Rs.12,750 towards interest for delay in deposit of tax.

(viii) The company had made an investment of Rs.25 lacs on the construction of a warehouse in rural area for the purpose of storage of agricultural produce. This was made available for use from 15.09.2017 and the income from this activity is credited in the Profit and Loss account under the head "Warehousing charges".

(ix) Depreciation under the Income-tax Act, 1961 works out at Rs.65,000.

(x) Interest on loans includes an amount of Rs.80,000 on which tax was not deducted.

Compute the income chargeable to tax for assessment year 2018-19 of Pingu Trading Pvt. Ltd, ignoring MAT. Support your answer with working notes.

Answer

Computation of Income of Pingu Trading Pvt. Ltd. chargeable to tax for the A.Y. 2018-19

Particulars	`
Net profit as per profit and loss account	33,90,000
Add: Difference in the value of stocks detected on survey under section 133A on 31.03.2018 chargeable as income **(See Note 1)**	3,75,000
142	37,65,000

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Less:	Income-tax refund credited in the profit and loss account, out of which interest is to be considered separately under the head "Income from other sources"	20,000
		37,45,000
Add:	**Expenses either not allowable or to be considered separately but charged in the profit & loss account**	
	Repair expenses on rented premises where assessee is under no obligation to incur such expenses are not allowable as per section 30(a)(i). However, if such expenses are required for carrying on the business efficiently, the same are allowable under section 37. In this case, assuming that such expenses are required for carrying on business efficiently, the same are allowable under section 37.	
	Advertisement in the souvenir of political party not allowable as per section 37(2B) **(See Note 3)**	2,500
	Payment made to the wife of a director examined as per section 40A(2) and the excess payment made to be disallowed **(See Note 5)**	75,000
	Payment made to electoral trust by cheque **(See Note 6)**	1,00,000
	Penalty levied by the Goods and Services tax department for delayed filing of returns not allowable as being paid for infraction of law **(See Note 7)**	5,300
	Depreciation as per books	71,500
	30% of interest paid on loan without deduction of tax at source not allowable as per section 40(a)(ia)	24,000
		40,23,300
Less:	Depreciation allowable as per Income-tax Act, 1961	65,000
		39,58,300
Less:	**Income from specified business (warehousing charges) credited to profit and loss account, to be considered separately** (See Note 8)	15,00,000
Income from business (other than specified business)		**24,58,300**
Computation of income/loss from specified business (See Note 8)		
Income from specified business	Rs.15,00,000	
Less: Deduction under section 35AD @ 100% of `25 lakhs	Rs.25,00,000	
Loss from specified business to be carried forward as per section 73A	**(10,00,000)**	

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Income from Other Sources			
Interest on income-tax refund			4,570
	Gross Total Income		**24,62,870**
Less:	**Deduction under section 80GGB**		
	Contribution to political party **(See Note 3)**	Rs.2,500	
	Contribution to an Electoral trust **(See Note 7)**	Rs.1,00,000	1,02,500
	Total Income		**23,60,370**

Notes:

(1) The business premises were surveyed and differences in the figures of opening and closing stocks and sales were found which have not been disputed and accepted by the assessee. Therefore, the trading account for the year is to be re-cast to arrive at the correct amount of the gross profit/ net profit for the purpose of return of income to be fi led for the previous year ended on 31.3.2018.

REVISED TRADING ACCOUNT

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

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

(2) Bonus for the previous year 2016-17 paid after the due date for filing return for that year would have been disallowed under section 43B for the P.Y.2016-17. However, when the same has been paid in December 2017, it should be allowed as deduction in the P.Y.2017-18(A.Y.2018-19). Since it is already included in the figure of bonus to staff debited to profit and loss account of this year, no further adjustment is required.

(3) The amount of Rs.2,500 paid for advertisement in the souvenir issued by a political party attracts disallowance under section 37(2B). However, such expe nditure falls within the meaning assigned to "contribute" under section 293A of the Companies Act, 1956, and is hence, eligible for deduction under section 80GGB. Any contribution to the political party or electoral trust made by way of cash is not allowed as deduction under section 80GGB. Since in the present case, the payment to the political party is made by way of an account payee cheque, it is allowed as deduction under section 80GGB.

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(4) The penalty of Rs.15,000 paid for non-fulfilment of delivery conditions of a contract for reasons beyond control is not for the breach of law but was paid for breach of contractual obligations and therefore, is an allowable expense.

(5) It has been assumed that Rs.25,000 is the reasonable payment for the wife of Director, working as a junior lawyer, since junior advocates of High Courts normally charge only Rs.25,000 for the same opinion and therefore, the balance Rs.75,000 has been disallowed.

(6) Payment to an electoral trust qualifies for deduction under section 80GGB since the payment is made by way of a cheque. However, since the amount has been debited to profit and loss account, the same has to be added back for computing business income.

(7) The interest of Rs.12,750 paid on the delayed deposit of goods and services tax is for breach of contract and hence, is allowable as deduction. However, penalty of Rs.5,300 for delay in filing of returns is not allowable since it is for breach of law.

(8) Deduction @ 100% of the capital expenditure is available under section 35A D in respect of specified business of setting up and operating a warehouse facility for storage of agricultural produce which commences operation on or after 1.04.2012. It is presumed that Rs.25 lacs does not include expenditure on acquisition of any land.

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

In view of the provisions of section 73A(1), the loss of Rs. 10 lacs from the specified business cannot be set-off against income from other businesses. Such loss has to be carried forward to be set-off against profit from specified business in the next assessment year. The return should be filed on or before the due date under section 139(1) for carry forward of such losses.

Question 7

(a) A Ltd. paid IDBI (a public financial institution) a lump sum pre-payment premium of Rs.1.2 lacs on 7.4.2017 for restructuring its debts and reducing its rate of interest. It claimed the entire sum as business expenditure for the P.Y.2017-18. The Assessing Officer, however, held that the pre-payment premium should be amortised over a period of 10 years (being the tenure of the restructured loan), and thus, allowed only 10% of the pre -payment premium in the P.Y.2017-18. Discuss, with reasons, whether the contention of A Ltd. is correct or that of the Assessing Officer.

(b) Explain the tax treatment of emergency spares (of plant and machinery) acquired during the year which, even though kept ready for use, have not actually been used during the relevant previous year.

Answer

(a) This issue came up before the Delhi High Court in CIT v. Gujarat Guardian Ltd (2009) 177 Taxman 434.The Court observed that the assessee company's claim for deduction has to be allowed in one lump sum keeping in view the provisions of section 43B(d), which provide that any sum payable by the assessee as interest on any loan or borrowing from any financial

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institution shall be allowed to the assessee in the year in which the same is paid, irrespective of the periods, in which the liability to pay such sum is incurred by the assessee according to the method of accounting regularly followed by the assessee.The High Court concurred with the Tribunal's view supporting the assessee that in terms of section 36(1)(iii) read with section 2(28A), the deduction for pre -payment premium was allowable. Since there was no dispute that the pre-payment premium was nothing but interest and that it was paid to a public financial institution i.e. IDBI, the Court held that, in terms of section 43B(d), the assessee's claim for deduction has to be allowed in the year in which the payment has actually been made.

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

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

(i) pre-payment premium represents interest as per section 2(28A);

(ii) such interest is deductible as business expenditure as per section 36(1)(iii);

(iii) such interest is deductible in one lump-sum on actual payment as per section 43B(d).

(b) As per ICDS V on Tangible Fixed Assets, machinery spares shall be charged to the revenue as and when consumed. When such spares can be used only in connection with an item of tangible fixed asset and their use is expected to be irregular, they shall be capitalised. Where the spares are capitalised as per the above requirement, the issue as to provision of depreciation arises – whether depreciation can be provided where such spares are kept ready for use or is it necessary that they are actually put to use. This issue was dealt with by the Delhi High Court in CIT v. Insilco Ltd (2010) 320ITR 322. The Court observed that the expression "used for the purposes of business" appearing in section 32 also takes into account emergency spares, which, even though read y for use, yet are not consumed or used during the relevant period. This is because these spares are specific to a fixed asset, namely plant and machinery, and form an integral part of the fixed asset. These spares will, in all probability, be useless once the asset is discarded and will also have to be disposed of. In this sense, the concept of passive use which applies to standby machinery will also apply to emergency spares. Therefore, once the spares are considered as emergency spares required for plant and machinery, the assessee would be entitled to capitalize the entire cost of such spares and claim depreciation thereon.

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

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Question 8

"Easy Call Ltd.", to provide telecom services in Mumbai, obtained a licence on 1.4.2015 for a period of 10 years ending on 31.3.2025 against a fee of Rs.27 lacs to be paid in 3 installments of Rs.9 lacs each by April, 2015, April, 2016 and April, 2017, respectively. The company has commenced business on 1.5.2016.

Explain, how the payment made for licence fee shall be dealt with under the Income -tax Act, 1961 and the amount, if any, deductible for A.Y. 2018-19.

Answer

The payment made for acquiring the licence to operate telecom services in Mumbai shall be subject to deduction as per the scheme in section 35ABB. As per section 35ABB, any amount actually paid for obtaining licence to operate telecommunication services shall be all owed as deduction in equal instalments during the number of years for which the license is in force.

If the payment is made before the commencement of business: The deduction shall be allowed beginning with the year of commencement of business.

In any other case: It will be allowed commencing from the year of payment. Deduction shall be allowed up to the year in which the license shall cease to be in force.

The amount of deduction available for A.Y. 2018-19 is worked out below:-

(1)	(2)	(3)	(4) = (3)/(2)
Previous year of payment	Unexpired period of license	Instalment paid (`)	Deduction in respect of each instalment (`)
2015-16	9 years	9,00,000	1,00,000
2016-17	9 years	9,00,000	1,00,000
2017-18	8 years	9,00,000	1,12,500
		27,00,000	**3,12,500**

The deduction under section 35ABB from assessment year 2018-19 shall be Rs.3,12,500.

Question 9

Alpha Ltd., a manufacturing company, has disclosed a net profit of Rs.12.50 lacs for the year ended 31st March, 2018. You are required to compute the taxable income of the company for the Assessment year 2018-19, after considering the following information, duly explaining the reasons for each item of adjustment:

(i) Advertisement expenditure debited to profit and loss account includes the sum of Rs.60,000 paid in cash to the sister concern of a director, the market value of which is Rs.52,000.

(ii) Repairs of plant and machinery debited to profit and loss account includes Rs. 1.80 lacs towards replacement of worn out parts of machineries. Such expenditure does not increase the future benefit from the asset beyond its previously assessed standard of performance.

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(iii) A sum of Rs.6,000 on account of liability foregone by a creditor has been taken to general reserve. The original purchases was debited to the Profit & Loss Account in the A.Y.2014-15.

(iv) Sale proceeds of import entitlements amounting to Rs.1 lac has been credited to Profit & Loss Account, which the company claims as capital receipt not chargeable to income-tax.

(v) Being also engaged in the biotechnology business, the company incurred the following expenditure on in-house research and development as approved by the prescribed authority:

(a) Research equipments purchased Rs.1,50,000.

(b) Remuneration paid to scientists Rs.50,000.

The total amount of Rs.2,00,000 is debited to the profit and loss account.

Answer

Computation of taxable income of Alpha Ltd. for the A.Y.2018-19

Particulars	`
Net profit as per profit and loss account	12,50,000
Add: Items debited to profit and loss A/c but not deductible	
1. **Payment of advertisement expenditure of `60,000**	
(i) Rs.8,000, being the excess payment to a relative disallowed under section 40A(2)	8,000
(ii) As the payment is made in cash and since the remaining amount of Rs.52,000 exceeds Rs.10,000, 100% shall be disallowed under section 40A(3)	52,000
2. Under section 31, expenditure relatable to current repairs regarding plant, machinery or furniture is allowed as deduction. The test to determine whether replacement of parts of machinery amounts to repair or renewal is whether the replacement is one which is in substance replacement of defective parts or replacement of the entire machinery or substantial part of the entire machinery [CIT v. Darbhanga Sugar Co. Ltd. [1956] 29 ITR 21 (Pat)]. Here expenditure on repairs does not bring in any new asset into existence. Such replacement can only be considered as current repairs. Hence, no adjustment is required. Further, as per ICDS V on Tangible Fixed Assets, only an expenditure that increases the future benefits from the existing asset beyond its previously assessed standard of performance has to be added to the actual cost.	

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3.	Liability foregone by creditor chargeable as business income but not credited to profit and loss account [taxable under section 41(1)]	6,000
4.	Sale proceeds of import entitlements. The sale of the rights gives rise to profits or gains taxable under section 28(iiia). As the amount has already been credited to profit and loss account, no further adjustment is necessary.	-
Less: Amount not debited to profit and loss account but allowable as deduction		
5.	Expenditure on in-house research and development is entitled to a weighted deduction of 150% of the expenditure (both capital and revenue) so incurred under section 35(2AB)(1) = `2 lacs x 150% = `3 lacs	1,00,000
	Expenditure of Rs.2,00,000 has already been debited to Profit & Loss Account, therefore only additional deduction of Rs.1 lacs further to be allowed	
	Taxable Income	**12,16,000**

Question 10

(i) A corporation was set up by the State Government transferring all the buses owned by it for a consideration of Rs.75 lacs, which was discharged by the Corporation by issue of equity shares. The Corporation in its assessment claimed depreciation. Can the dep reciation be denied in the Corporation's hands on the ground that there was no registration of the buses in favour of the Corporation?

(ii) Ravi succeeded to his father's business in the year 2015. In the previous year ended 31.3.2018, Ravi has written off the balance in the name of 'Y' which relates to supply made by his father, when he carried on business. Ravi desires to know whether the write off could be eligible for deduction.

Answer

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

Registration of the buses is only a formality to perfect the title and does not bar enjoyment. The Corporation cannot, therefore, be denied depreciation on the buses. A similar decision was also taken in CIT v. J & K Tourism Development Corporation (2001) 114 Taxman 734 (J&K).

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

Therefore, Ravi is eligible for deduction in respect of the amount due in the name of Y which is written off in the books of account as bad debt, even though the debt represents the amount

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due for the supplies made by previous owner viz. deceased father of Ravi.[CIT v. T. Veerabhadra Rao, K. Koteswara Rao and Co (1985) 155 ITR 152 (SC)].

Question 11

Boat Club is an association governed by the provisions of Section 44A of the Income -tax Act, 1961.The subscription received from members for the year ended 31st March, 2018 was Rs.2,00,000. The expenditures in the normal course of its activities were Rs. 3,85,000. Its other income taxable under the Act works out to Rs.2,75,000. You are consulted as to how Boat Club's income would be determined for assessment year 2018-19?

Answer

As per section 44A, the deficiency arising on account of income from members by way of, inter alia, subscriptions, falling short of the expenditure incurred solely for the protection or advancement of the interest of its members, shall first be set off against the association's income under the head "Profits and gains of Business or Profession". If there is no such income under this head, the deficiency shall be set off against income under any other head.

Particulars	`
Income from subscription	2,00,000
Less: Expenses incurred in the course of its activities	3,85,000
Deficiency	(-)1,85,000
Other income	2,75,000
Less: Deficiency Rs.1,85,000 but limited to 50% of other income	1,37,500
Income of the Association	**1,37,500**

There is a ceiling on the deduction admissible by way of deficiency being that it shall not exceed one-half of the total income of the association computed before making any allowance under this section. This ceiling has been exceeded above and the deficiency hence is limited to Rs.1,37,500 being one-half of `2,75,000 [vide section 44A(3)].

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SIGNIFICANT SELECT CASES

1. Is interest income on margin money deposited with bank for obtaining bank guarantee to carry on business, taxable as business income?

CIT v. K and Co. (2014) 364 ITR 93 (Del)

Facts of the case: The assessee running a lottery, deposited certain funds with a bank in order to obtain bank guarantee to be furnished to the State Government of Sikkim. Such guarantee enabled the assessee to carry on the business of printing lottery tickets and for conducting lotteries on behalf of the State Government of Sikkim. The funds which were held as margin money, earned some interest.

Issue: The issue under consideration is whether such interest income would be taxable under the head 'Profits and Gains from Business or Profession' or under the head 'Income from other sources'.

High Court's Observations: The High Court noted that the interest income from the deposits made by the assessee is inextricably linked to the business of the assessee and such income, therefore, cannot be treated as income under the head 'Income from other sources'. The margin money requirement was an essential element for obtaining the bank guarantee which was necessary for the contract between the State Government of Sikkim and the assessee. If the assessee had not furnished bank guarantee, it would not have got the contract for running the said lottery

High Court Decision: The High Court, accordingly, held that the interest income received on funds kept as margin money for obtaining the bank guarantee would be taxable under the head "Profits and gains of business or profession".

2. Can depreciation on leased vehicles be denied to the lessor on the ground that the vehicles are registered in the name of the lessee and that the lessor is not the actual user of the vehicles?

I.C.D.S. Ltd. v. CIT (2013) 350 ITR 527 (SC)

Facts of the case: The assessee is a non-banking finance company engaged, inter alia, in the business of leasing and hire purchase. The assessee purchased vehicles directl y from the manufacturers and as a part of its business, leased out these vehicles to its customers, after which the physical possession of the vehicles was with the lessee. Further, the lessees were registered as the owners of the vehicles in the certificate of registration issued under the Motor Vehicles Act, 1988. The assessee-lessor claimed depreciation on such vehicles.

The Assessing Officer disallowed the depreciation claim on the ground that the assessee's use of these vehicles was only by way of leasing out the vehicles to others and not as actual

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user of the vehicles in the business of running them on hire and secondly, the vehicles were registered in the name of the lessee and not the assessee-lessor. Therefore, according to the Assessing Officer, the assessee had merely financed the purchase of these assets and was neither the owner nor the user of these assets.

High Court's view: The High Court was also of the view that the assessee could not be treated as the owner of the vehicles, since the vehicles were not registered in the name of the assessee and the assessee had only financed the transaction. Therefore, the High Court held that the assessee was not entitled to claim depreciation.

Supreme Court's Observations: The Supreme Court observed that section 32 imposes a twin requirement of "ownership" and "usage for business" as conditions for claim of depreciation thereunder. The Apex Court further observed that as far as usage of the asset is concerned, the section requires that the asset must be used in the course of business. It does not mandate actual usage by the assessee itself. In this case, the assessee did use the vehicles in the course of its leasing business. Hence, this requirement of section 32 has been fulfilled, notwithstanding the fact that the assessee was not the actual user of the vehicles.

The Supreme Court further noted that section 2(30) of the Motor Vehicle Act, 1988, is a deeming provision which creates a legal fiction of ownership in favour of the lessee only for that Act, not for the purpose of law in general. No inference could be drawn from the registration certificate as to ownership of the legal title of the vehicles, since registration in the name of the lessee during the period of lease is mandatory as per the Motor Vehicles Act, 1988. If the lessee was in fact the legal owner, he would have claimed depreciation on the vehicles which was not the case.

The Apex Court observed that as long as the assessee-lessor has a right to retain the legal title against the rest of the world, he would be the owner of the asset in the eyes of law. In this regard, the following provisions of the lease agreement are noteworthy –

- The assessee is the exclusive owner of the vehicle at all points of time;
- The assessee is empowered to repossess the vehicle, in case the lessee committed a default;
- At the end of the lease period, the lessee was obliged to return the vehicle to the assessee;
- The assessee had a right of inspection of the vehicle at all times.

It can be seen that the proof of ownership lies in the lease agreement itself, which clearly points in favour of the assessee.

Supreme Court's Decision: The Supreme Court, therefore, held that assessee was entitled to claim depreciation in respect of vehicles leased out since it has satisfied both the requirements of section 32, namely, ownership of the vehicles and its usage in the course of business.

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3. What is the eligible rate of depreciation in respect of computer accessories and peripherals under the Income-tax Act, 1961?

CIT v. BSES Yamuna Powers Ltd (2013) 358 ITR 47 (Delhi)

Assessee's contention vis-a-vis Department's contention: The assessee claimed depreciation on computer accessories and peripherals at the rate of 60%, being the eligible rate of depreciation on computers including computer software. However, the Revenue contended that computer accessories and peripherals cannot be treated at par with computers and computer software, and hence were eligible for depreciation at the general rate applicable to plant and machinery, i.e., 15%.

High Court's Decision: The High Court observed that computer accessories and peripherals such as printers, scanners and server etc. form an integral part of the computer system and they cannot be used without the computer. Consequently, the High Court held that since they are part of the computer system, they would be eligible for depreciation at the higher rate of 60% applicable to computers including computer software.

The Delhi High Court, in CIT v. Orient Ceramics and Industries Ltd. [2013] 358 ITR 0049, following its own judgment in the above case, held that depreciation on UPS is allowable @ 60%, being the eligible rate of depreciation on computers including computer software, and not at the general rate of 15% applicable to plant and machinery.

***Note:** The CBDT has, vide Notification No. 103/2016, dated 7-11-2016, with effect from A.Y. 2018-19 reduced the higher rate of normal depreciation of 50%, 60%, 80% or 100%, as the case may be to 40%.*

Accordingly, with effect from A.Y. 2018-19, the applicable rate of normal depreciation for computers would be 40% and hence, the eligible rate of depreciation on* computer accessories and peripherals such as printers, scanners and server etc. or *UPS would be 40%.

4. Can business contracts, business information, etc., acquired by the assessee as part of the slump sale and described as 'goodwill', be classified as an intangible asset to be entitled for depreciation under section 32(1)(ii)?

Areva T and D India Ltd. v. DCIT (2012) 345 ITR 421 (Delhi)

Facts of the case: In the present case, a transferor under a transfer by way of slump sale, transferred its ongoing business unit to the assessee company. On perusal of the sale consideration, it was found that some part of it was attributable to the tangible assets and the balance payment was made by the assessee company for acquisition of various business and commercial rights categorized under the separate head, namely, "goodwill" in the books of

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account of the assessee. These business and commercial rights comprised the following: business claims, business information, business records, contracts, skilled employees, know - how. The assessee company claimed depreciation under section 32 on the excess amount paid which was classified as "goodwill" under the category of intangible assets.

Assessing Officer's contention vis-a-vis Assessee's contention: The Assessing Officer accepted the allocation of the slump sale between tangible and intangible assets (described as Goodwill). However, he claimed that depreciation in terms of section 32(1)(ii) is not allowable on goodwill. He further contended that the assessee has failed to prove that such payment can be categorized under "other business or commercial right of simila r nature" as mentioned in section 32(1)(ii) to qualify for depreciation.

The assessee argued that any right which is obtained for carrying on the business effectively, is likely to come within the sweep of the meaning of intangible asset. Therefore, the present case shall qualify for claiming depreciation since business claims, business information, etc, are in the nature of "any other business or commercial rights". However, the Revenue argued that, the business or commercial rights acquired by the assessee would not fall within the definition of intangible assets under section 32.

High Court's Observations: The Delhi High Court observed that the principle of ejusdem generis provides that where there are general words following particular and specific wor ds, the meaning of the latter words shall be confined to things of the same kind. The Court applied this principle for interpreting the expression "business or commercial rights of similar nature" specified in section 32(1)(ii). It is seen that such rights need not be the same as the description of "know-how, patents, trademarks, licenses or franchises" but must be of similar nature as that of specified assets. The use of these general words after the specified intangible assets in section 32(1)(ii) clearly demonstrates that the Legislature did not intend to provide for depreciation only in respect of specified intangible assets but also to other categories of intangible assets, which were neither feasible nor possible to exhaustively enumerate.

Further, it was observed that the above mentioned intangible assets are invaluable assets, which are required for carrying on the business acquired by the assessee without any interruption. In the absence of the aforesaid intangible assets, the assessee would have had to commence business from scratch and go through the gestation period whereas by acquiring the aforesaid business rights along with the tangible assets, the assessee has got a running business. The aforesaid intangible assets are, therefore, comparable to a license to carry on the existing business of the transferor.

High Court's Decision: The High Court, therefore, held that the specified intangible assets acquired under the slump sale agreement by the assessee are in the nature of intangible asset under the category "other business or commercial rights of similar nature" specified in section 32(1)(ii) and are accordingly eligible for depreciation under section 32(1)(ii).

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5. Is the assessee entitled to depreciation on the value of goodwill considering it as an asset within the meaning of Explanation 3(b) to Section 32(1)?

CIT v. Smifs Securities Ltd. (2012) 348 ITR 302 (SC)

Facts of the case: In this case, the assessee has paid an excess consideration over the value of net assets of the amalgamating company acquired by it, which is treated as goodwill, since the extra consideration was paid towards the reputation which the amalgamating company was enjoying in order to retain its existing clientele. The assessee had claimed depreciation on the said goodwill. However, the Assessing Officer contended that the goodwill is not an asset falling under Explanation 3 to section 32(1) and therefore, is not eligible for depreciation.

Supreme Court's Observations: On this issue, the Supreme Court observed that Explanation 3 to section 32(1) states that the expression 'asset' shall mean an intangible asset, being know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature.

Supreme Court's Decision: A reading of the words 'any other business or commercial rights of similar nature' in *Explanation 3(b)* indicates that goodwill would fall under the said expression. In the process of amalgamation, the amalgamated company had acquired a capital right in the form of goodwill because of which the market worth of the amalgamated company stood increased.

Therefore, it was held that 'Goodwill' is an asset under *Explanation 3(b)* to section 32(1) and depreciation thereon is allowable under the said section.

6. Can EPABX and mobile phones be treated as computers to be entitled to higher depreciation?
Federal Bank Ltd. v. ACIT (2011) 332 ITR 319 (Kerala)

High Court's Decision: On this issue, the High Court held that the rate of depreciation of 60% is available to computers and there is no ground to treat the communication equipment as computers. Hence, EPABX and mobile phones are not computers and therefore, are not entitled to higher depreciation at 60%.

The CBDT has, vide Notification No. 103/2016, dated 7-11-2016, with effect from A.Y. 2018-19 reduced the higher rate of normal depreciation of 50%, 60%, 80% or 100%, as the case may be to 40%.

Accordingly, with effect from A.Y. 2018-19, the applicable rate of normal depreciation for computers would be 40%.

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7. Would beneficial ownership of assets suffice for claim of depreciation on such assets?

CIT v. Smt. A. Sivakami and Another (2010) 322 ITR 64 (Mad.)

Facts of the case: The assessee, running a proprietary concern, claimed depreciation on three buses, even though she was not the registered owner of the same. However, in order to establish that she was the beneficial owner, she furnished documents relating to loans obtained for the purchase of buses, repayment of such loans out of collections from the buses, road tax and insurance paid by her. She had also obtained an undertaking from the persons who hold the legal title to the vehicles as well as the permits, for plying buses in the name of her proprietary concern. Further, in the income and expenditure account of the proprietary concern, the entire collections and expenditure (by way of diesel, driver's salary, spares, R.T.O. tax etc.) from the buses was shown. The buses in dispute were also shown as assets in the balance sheet of the proprietary concern.

The assessee claimed depreciation on these buses. The Assessing Officer rejected the claim of the assessee on the ground that the assessee was not the owner of the three buses and the basic condition under section 32(1) to claim depreciation is that the assessee should be the owner of the asset. The Assessing Officer was of the view that mere admission of the income cannot per se permit the assessee to claim depreciation.

High Court's Observations: The High Court observed that in the context of the Income-tax Act, 1961, having regard to the ground realities and further having regard to the object of the Act i.e., to tax the income, the owner is a person who is entitled to receive income from the property in his own right. The Supreme Court, in CIT v. Podar Cement P Ltd. (1997) 226 ITR 625, observed that the owner need not necessarily be the lawful owner entitled to pass on the title of the property to another.

High Court's Decision: Since, in this case, the assessee has made available all the documents relating to the business and also established before the authorities that she is the beneficial owner, the High Court held that she was entitled to claim depreciation even though she was not the legal owner of the buses.

8. Can employees contribution to Provident Fund and Employee's State Insurance be allowed as deduction where the assessee-employer had not remitted the same on or before the "due date" under the relevant Act but remitted the same on or before t he due date for filing of return of income under section 139(1)?

CIT v. Gujarat State Road Transport Corpn (2014) 366 ITR 170 (Guj)

Facts of the case: The assessee collected employees' contribution to Provident Fund and ESI which were remitted, after the due date under the relevant Acts but before the 'due date' for filing the return specified in section 139(1). The assessing authority held that the amo unt

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collected by way of employees' contribution to PF and ESI are income under section 2(24)(x) and their remittance is governed by section 36(1)(va). The time limit prescribed for remitting the contribution is the 'due date' prescribed under the Provident Funds Act, Employees' State Insurance Act, rule, order or notification issued thereunder or under any standing order, award, contract or service or otherwise.

Issue: The issue under consideration is whether extended time limit upto the due date of filing the return contained in section 43B would be available in respect of remittances which are governed by section 36(1)(va).

High Court's Observations: The High Court noted that section 43B(b) pertaining to employer's contribution cannot be applied with respect to employees' contribution which is governed by section 36(1)(va). So far as the employee's contribution is concerned, the Explanation to section 36(1)(va) continues to remain in the statute and there is no provision for applying the extended time limit provided under section 43B for remittance of employee's contribution. The amount of employee's contribution to PF and ESI is an income upon recovery from salary and its remittance within the 'due date' as specified in Explanation to section 36(1)(va) makes it eligible for deduction. Employees' contribution recovered by the employer is not eligible for extended time limit upto the due date of filing of return, which is available under section 43B in the case of employer's own contribution.

High Court's Decision: The High Court, accordingly, held that the delayed remittance of employees' contribution beyond the 'due date' prescribed in section 36(1)(va), is not deductible while computing the business income, even though such remittance has been made before the due date of filing of return of income under section 139(1).

Note: *A contrary view was expressed by Uttrakhand High Court in the case of CIT v. Kichha Sugar Co. Ltd. (2013) 356 ITR 351 holding that the employees' contribution to provident fund, deducted from the salaries of the employees of the assessee, shall be allowed as deduction from the income of the employer-assessee, if the same is deposited by the employer-assessee with the provident fund authority on or before the due date of filing the return for the relevant previous year.*

9. What is the nature of expenditure incurred on glow-sign boards displayed at dealer outlets - capital or revenue?

CIT v. Orient Ceramics and Industries Ltd. (2013) 358 ITR 49 (Delhi)

High Court's Observations: On this issue, the Delhi High Court noted the following observations of the Punjab and Haryana High Court in CIT v. Liberty Group Marketing Division [2009] 315 ITR 125, while holding that such expenditure was revenue in nature -

(i) The expenditure incurred by the assessee on glow sign boards does not bring into

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existence an asset or advantage for the enduring benefit of the business, which is attributable to the capital.

(ii) The glow sign board is not an asset of permanent nature. It has a short life.

(iii) The materials used in the glow sign boards decay with the effect of weather. Therefore, it requires frequent replacement. Consequently, the assessee has to incur expenditure on glow sign boards regularly in almost each year.

(iv) The assessee incurred expenditure on the glow sign boards with the object of facilitating the business operation and not with the object of acquiring asset of enduring nature.

High Court's Decision: The Delhi High Court concurred with the above observations of the P & H High Court and held that such expenditure on glow sign boards displayed at dealer outlets was revenue in nature.

10. Would the expenditure incurred on issue and collection of convertible debentures be treated as revenue expenditure or capital expenditure?

CIT v. ITC Hotels Ltd. (2011) 334 ITR 109 (Kar.)

High Court's Decision: On this issue, the Karnataka High Court held that the expenditure incurred on the issue and collection of debentures shall be treated as revenue expenditure even in case of convertible debentures, i.e., the debentures which had to be converted into shares at a later date.

11. Would expenditure incurred on feasibility study conducted for examining proposals for technological advancement relating to the existing business be classified as a revenue expenditure, where the project was abandoned without creating a new asset?

CIT v. Priya Village Roadshows Ltd. (2011) 332 ITR 594 (Delhi)

Facts of the case: In this case, the assessee, engaged in the business of running cinemas, incurred expenditure towards architect fee for examining the technical viability of the proposal for takeover of cinema theatre for conversion into a multiplex/ four-screen cinema complexes. The project was, however, dropped due to lack of financial and technical viabili ty. The issue under consideration is whether such expenses can be treated as revenue in nature, since no new asset has been created.

High Court's Observations: On this issue, the High Court observed that, in such cases, whether or not a new business/asset comes into existence would become a relevant factor. If there is no creation of a new asset, then the expenditure incurred would be of revenue nature.

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High Court's Decision: The High Court held that, since the feasibility studies were conducted by the assessee for the existing business with a common administration and common fund and the studies were abandoned without creating a new asset, the expenses were of revenue nature.

12. Can expenditure incurred on alteration of a dam to ensure adequate supply of water for the smelter plant owned by the assessee be allowed as revenue expenditure?

CIT v. Hindustan Zinc Ltd. (2010) 322 ITR 478 (Raj.)

Facts of the case: The assessee company owned a super smelter plant which requires large quantity of water for its day-to-day operation, in the absence of which it would not be able to function. The assessee, therefore, incurred expenditure for alteration of the dam (constructed by the State Government) to ensure sharing of the water with the State Government without having any right or ownership in the dam or water. The assessee's share of water is also determined by the State Government. The assessee claimed the expenditure as deduction under section 37, which was disallowed by the Assessing Officer on the ground that it was of capital nature.

Tribunal view: The Tribunal, however, was of the view that since the object and effect of the expenditure incurred by the assessee is to facilitate its trade operation and enable the management to conduct business more efficiently and profitably, the expenditure is revenue in nature and hence, allowable as deduction.

High Court's Observations & Decision: The High Court observed that the expenditure incurred by the assessee for commercial expediency relates to carrying on of business. The expenditure is of such nature which a prudent businessman may incur for the purpose of his business. The operational expenses incurred by the assessee solely intended for the furtherance of the enterprise can by no means be treated as expenditure of capital nature.

13. Is Circular No. 5/2012 dated 01.08.2012 disallowing the expenditure incurred on freebies provided by pharmaceutical companies to medical practitioners, in line with Explanation to section 37(1), which disallows expenditure which is prohibited by law?

Confederation of Indian Pharmaceutical Industry (SSI) v. CBDT (2013) 353 ITR 388 (H.P.)

High Court's Observations: On this issue, the Himachal Pradesh High Court observed that as per Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, every medical practitioner and his or her professional associate is prohibited from accepting any gift, travel facility, hospitality, cash or monetary grant from any pharmaceutical and allied health sector industries. This is a salutary regulation in the interest of the patients and the public, considering the increase in complaints against the medical practitioners prescribing branded medicines instead of generic medicines, solely in lieu of gifts and other freebies granted to them by some particular pharmaceutical industries.

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The CBDT, considering the fact that the claim of any expense incurred in providing freebies to medical practitioners is in violation of the provisions of Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, has, vide Circular No.5/2012 dated 1.8.2012, clarified that the expenditure so incurred shall be inadmissible under section 37(1). The disallowance shall be made in the hands of such pharmaceutical or allied health sector industry or other assessee which has provided aforesaid freebies and claimed it as a deductible expense in its accounts against income.

High Court's Decision: The High Court opined that the contention of the assessee that the above mentioned Circular goes beyond section 37(1) was not acceptable. As per *Explanation* to section 37(1), it is clear that any expenditure incurred by an assessee for any purpose which is prohibited by law shall not be deemed to have been incurred for the purpose of business or profession. The sum and substance of the circular is also th e same. Therefore, the circular is totally in line with the *Explanation* to section 37(1).

However, if the assessee satisfies the assessing authority that the expenditure incurred is not in violation of the regulations framed by the Medical Council then it may legitimately claim a deduction, but it is for the assessee to satisfy the Assessing Officer that the expense is not in violation of the Medical Council Regulations.

14. Can the commission paid to doctors by a diagnostic centre for referring patients fo r diagnosis be allowed as a business expenditure under section 37 or would it be treated as illegal and against public policy to attract disallowance?

CIT v. Kap Scan and Diagnostic Centre P. Ltd. (2012) 344 ITR 476 (P&H)

High Court's Observations: On the above mentioned issue, the Punjab and Haryana High Court observed that the argument of the assessee that giving commission to the private doctors for referring the patients for various medical tests was a trade practice which could not be termed to be illegal and therefore, the same cannot be disallowed under section 37(1), is not acceptable. Applying the rationale and considering the purpose of Explanation to section 37(1), the assessee would not be entitled to deduction of payments made in contravention of law. Similarly, payments which are opposed to public policy being in the nature of unlawful consideration cannot also be claimed as deduction. The assessee cannot take a plea that businessmen are entitled to conduct their business even contrary t o law and claim deduction of certain payments as business expenditure, notwithstanding that such payments are illegal or opposed to public policy or have pernicious consequences to the society as a whole.

As per the Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002, no physician shall give, solicit, receive, or offer to give, solicit or receive, any gift, gratuity, commission or bonus in consideration of a return for referring any patient for medical treatment.

High Court's Decision: The demanding as well as paying of such commission is bad in law. It is not a fair practice and is opposed to public policy and should be discouraged. Thus, the High Court held that commission paid to doctors for referring patients for diagno sis is not allowable as a business expenditure.

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15. Can expenditure incurred by a company on higher studies of the director's son abroad be claimed as business expenditure under section 37 on the contention that he was appointed as a trainee in the company under "apprentice training scheme", where there was no proof of existence of such scheme?

Echjay Forgings Ltd. v. ACIT (2010) 328 ITR 286 (Bom.)

High Court's Observations: On this issue, it was observed that there was no evidence on record to show that any other person at any point of time was appointed as trainee or sent abroad for higher education. Further, the appointment letter to the director's son, neither had any reference number nor was it backed by any previous application by him. The appointmen t letter referred to "apprentice training scheme" with the company in respect of which no details were produced. There was no evidence that he was recruited as trainee by some open competitive exam or regular selection process.

High Court's Decision: The High Court, thus, held that there was no nexus between the education expenditure incurred abroad for the director's son and the business of the assessee company. Therefore, the aforesaid expenditure was not deductible.

16. Can the expenditure incurred on heart surgery of an assessee, being a lawyer by profession, be allowed as business expenditure under section 31, by treating it as current repairs considering heart as plant and machinery, or under section 37, by treating it as expenditure incurred wholly and exclusively for the purpose of business or profession?

Shanti Bhushan v. CIT (2011) 336 ITR 26 (Delhi)

Facts of the case: In the present case, the assessee is a lawyer by profession. The assessee argued that the repair of vital organ (i.e. the heart) had directly impacted his professional competence. He contended that the heart should be treated as plant as it is used for the purpose of his professional work. He substantiated his contention by stat ing that after his heart surgery, his gross receipts from profession increased manifold. Hence, the expenditure on the heart surgery should be allowed as business expenditure either under section 31 as current repairs to plant and machinery or section 37 as an expense incurred wholly and exclusively for the purpose of profession. The department argued that the said expenditure was personal in nature and was not incurred wholly and exclusively for the purpose of business or profession, and therefore, the sam e should not be allowed as business expenditure.

High Court's Observations: On this issue, the Delhi High Court observed that a healthy and functional human heart is necessary for a human being irrespective of the vocation or profession he is attached with. Expenses incurred to repair an impaired heart would thus add to the longevity and efficiency of a human being which would be reflected in every activity he does, including professional activity. It cannot be said that the heart is used as an exclusive t ool for the purpose of professional activity by the assessee. Further, the High Court held that:-

(i) To allow the heart surgery expenditure as repair expenses to plant, the heart should have been first included in the assessee's balance sheet as an asset in the previous year and in the earlier years. Also, a value needs to be assigned for the same. The assessee would

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face difficulty in arriving at the cost of acquisition of such an asset for showing in his books of account.

Though the definition of "plant" as per the provisions of section 43(3) is inclusive in nature, such plant must have been used as a business tool which is not true in case of heart. Therefore, the heart cannot be said to be plant for the business or profession of the assessee. Therefore, the expenditure on heart surgery is not allowable as repairs to plant under section 31.

(ii) According to the provisions of section 37, inter alia, the said expenditure must be incurred **wholly and exclusively** for the purposes of the assessee's profession. As mentioned above, a healthy heart will increase the efficiency of human being in every field including its professional work.

High Court's Decision: There is, therefore, no **direct nexus** between the expenses incurred by the assessee on the heart surgery and his efficiency in the professional field. Therefore, the claim for allowing the said expenditure under section 37 is also not tenable. Hence, the heart surgery expenses shall not be allowed as a business expenditure of the assessee under the Income-tax Act, 1961.

17. Can payment to police personnel and gundas to keep away from the cinema theatres run by the assessee be allowed as deduction?

CIT v. Neelavathi & Others (2010) 322 ITR 643 (Karn)

Facts of the case: The assessee running cinema theatres claimed deduction of the sum paid to the local police and local gundas towards maintenance of the theatre. The same was disallowed by the Assessing Officer.

High Court's Observations: On this issue, the High Court observed that if any payment is made towards the security of the business of the assessee, such amount is allowable as deduction, as the amount is spent for maintenance of peace and law and order in the business premises of the assessee i.e., cinema theatres in this case. However, the amount claimed by the assessee, in the instant case, was towards payment made to the police and gundas.

Any payment made to the police illegally amounts to bribe and such illegal gratification cannot be considered as an allowable deduction. Similarly, any payment to a gunda as a precautionary measure so that he shall not cause any disturbance in the theatre run by the assessee is an illegal payment for which no deduction is allowable under the Act.

High Court's Decision: If the assessee had incurred expenditure for the purpose of security, the same would have been allowed as deduction. However, in the instant case, since the payment has been made to the police and gundas to keep them away from the business premises, such a payment is illegal and hence, not allowable as deduction.

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18. Is the amount paid by a construction company as regularization fee for violating building bye-laws allowable as deduction?

Millennia Developers (P) Ltd. v. DCIT (2010) 322 ITR 401 (Karn.)

Facts of the case: The assessee, a private limited company carrying on business activity as a developer and builder, claimed the amount paid by way of regularization fee for the deviations made while constructing a structure and for violating the plan sanctioned in terms of the building bye-laws, approved by the municipal authorities as per the provisions of the Karnataka Municipal Corporations Act, 1976. The assessee's claim was disallowed by the Assessing Officer and the disallowance was confirmed by the Tribunal.

High Court's Observations and Decision: The High Court observed that as per the provisions of the Karnataka Municipal Corporations Act, 1976, the amount paid to compound an offence is obviously a penalty and hence, does not qualify for deduction under section 37. Merely describing the payment as a compounding fee would not alter the character of the payment.

***Note** – In this case, it is the actual character of the payment and not its nomenclature that has determined the disallowance of such expenditure as deduction. The principle of substance over form has been applied in disallowing an expenditure in the nature of penalty, though the same has been described as regularization fee/compounding fee.*

19. Can remuneration paid to working partners as per the partnership deed be considered as unreasonable and excessive for attracting disallowance under section 40A(2)(a) even though the same is within the statutory limit prescribed under section 40(b)(v)?

CIT v. Great City Manufacturing Co. (2013) 351 ITR 156 (All)

Facts of the case: In this case, the Assessing Officer contended that the remuneration paid by the firm to its working partners was highly excessive and unreasonable, on the ground that the remuneration to partners (Rs.39.31 lakh) was many times more than the total payment of salary to all the employees (Rs.4.87 lakh). Therefore, he disallowed the excessive portion of the remuneration to partners by invoking the provisions of section 40A(2)(a).

High Court's Observations: On this issue, the High Court observed that section 40(b)(v) prescribes the limit of remuneration to working partners, and deduction is allowable up to such limit while computing the business income. If the remuneration paid is within the ceiling limit provided under section 40(b)(v), then, recourse to provisions of section 40A(2)(a) cannot be taken.

The Assessing Officer is only required to ensure that the remuneration is paid to the working partners mentioned in the partnership deed, the terms and conditions of the partnership deed provide for payment of remuneration to the working partners and the remuneration is within the limits prescribed under section 40(b)(v). If these conditions are complied with, then the Assessing Officer cannot disallow any part of the remuneration on the ground that it is excessive.

High Court's Decision: The Allahabad High Court, therefore, held that the question of disallowance of remuneration under section 40A(2)(a) does not arise in this case, since the Tribunal has found that all the three conditions mentioned above have been satisfied. Hence, the remuneration paid to working partners within the limits specified under section 40(b)(v) cannot be disallowed by invoking the provisions of section 40A(2)(a).

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20. In a case where payment of bonus due to employees is paid to a trust and such amount is subsequently paid to the employees before the stipulated due date, would the same be allowable under section 36(1)(ii) while computing business income?

Shasun Chemicals & Drugs Ltd v. CIT (2016) 388 ITR 1 (SC)

Facts of the case: The assessee-company and its employees union had a dispute as regard the quantum of bonus which led to labour unrest. Due to this reason, the workers refused to accept the bonus offered to them. However, in order to comply with the requirement of section 43B (i.e., deduction in respect of bonus would be allowable only if actual payment is made) the assessee made payment to a trust. The dispute with the workers was settled well in time and the bonus was paid to the workers on the very next day of deposit of the said amount in the trust that too, before the 'due date' by which such payment is supposed to be made in order to claim deduction under section 36.

The Assessing Officer, however, took a view that since the payment was made from the trust and not made by the assessee directly to the employees, it is not allowable in view of the provisions of section 40A(9) of the Act.

Appellate Authorities views: The Commissioner(Appeals) and the Appellate Tribunal did not accept the Assessing Officer's view but the High Court concurred with the Assessing Officer's view and denied deduction under section 36(1)(ii) to the assessee.

Supreme Court's decision: The Apex Court held that section 36(1) contains various kinds of expenses which are allowable as deduction while computing the business income. The amount paid by way of bonus is one such expenditure which is allowable as deduction under section 36(1)(ii).

It also held that the embargo contained in section 43B(b) or section 40A(9) does not come in the way of the assessee's claim, since the bonus was ultimately paid to the employees before the due date as per the statutory requirement. Therefore, the payment in respect of bonus is allowable as deduction, as there is no dispute that the amount was paid by the assessee to its employees before the due date by which such payment is supposed to be made in order to claim deduction under section 36(1)(ii).

Note – *In this case, the Supreme Court has held that the bonus was allowable as deduction under section 36(1)(ii), even though it was initially remitted to the trust created for this purpose, from which the payment was ultimately made to the employees before the due date.*

The Supreme Court has applied the concept of "substance over form" in allowing the deduction of bonus paid under section 36(1)(ii) by considering that the payment of bonus was ultimately made to employees before the stipulated due date. Applying the same concept, the intermittent process of creation of trust for remittance of bonus and subsequent payment therefrom to the employees, which formed the basis of disallowance of bonus by the Assessing Officer on the basis of the provisions of section 40A(9) has been ignored. However, had the payment to employees not been made before the stipulated due date, deduction under section 36(1)(ii) would not be allowable merely because the amount was remitted to the trust before the stipulated due date. It may be noted that as per section 43B(c), actual payment before the due date of filing of return of income under section 139(1) is a pre-requisite for claiming deduction under section 36(1)(ii).

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Illustration 1

X converts his capital asset (acquired on June 10, 2002 for Rs.60,000) into stock-in-trade on March 10, 2017. The fair market value on the date of the above conversion was Rs.3,50,000. He subsequently sells the stock-in-trade so converted for Rs.4,00,000 on June 10, 2017. Examine the tax implication.

Cost Inflation Index - F.Y. 2002-03: 105; F.Y. 2016-17: 264

Solution

Since the capital asset is converted into stock-in-trade during the previous year relevant to the A.Y. 2017-18, it will be a transfer under section 2(47) during the P.Y.2016-17. However, the profits or gains arising from the above conversion will be chargeable to tax during the A.Y. 2018-19, since the stock-in-trade has been sold only on June 10, 2017. For this purpose, the fair market value on the date of such conversion (i.e. 10th March, 2017) 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 2002-03 i.e., the year of acquisition is 105 and the index for the year of transfer i.e., 2016-17 is 264. The indexed cost of acquisition is 60,000 × 264/105 = Rs.1,50,857. Hence, Rs.1,99,143 (i.e. Rs.3,50,000 – Rs.1,50,857) will be treated as long-term capital gains chargeable to tax during the A.Y.2018-19. During the same assessment year, Rs.50,000 (Rs.4,00,000 - Rs.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)]*.

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.

Illustration 2

M held 2000 shares in a company ABC Ltd. This company amalgamated with another company during the previous year ending 31-3-2018. Under the scheme of amalgamation, M was allotted 1000 shares in the new company. The market value of shares allotted is higher by Rs.50,000 than the value of holding in ABC Ltd.

The Assessing Officer proposes to treat the transaction as an exchange and to tax Rs.50,000 as capital gain. Is he justified?

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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.

Illustration 3

In which of the following situations capital gains tax liability does not arise?

(i) Mr. A purchased gold in 1970 for Rs.25,000. In the P.Y. 2017-18, 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 Rs.1,00,000.

(ii) A house property is purchased by a Hindu undivided family in 1945 for Rs.20,000. It is given to one of the family members in the P.Y. 2017-18 at the time of partition of the family. FMV on the day of partition was Rs.12,00,000.

(iii) Mr. B purchased 50 convertible debentures for Rs.40,000 in 1995 which are converted in to 500 shares worth Rs.85,000 in November 2017 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.

Illustration 4

Mr. Abhishek a senior citizen, mortgaged his residential house with a bank, under a notified reverse mortgage scheme. He was getting loan from bank in monthly installments. Mr. Abhishek did not repay the loan on maturity and hence gave possession of the house to the bank, to discharge his loan. How will the treatment of long-term capital gain be on such reverse mortgage transaction?

Solution:

Section 47(xvi) provides that any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government shall not be considered as a transfer for the purpose of capital gain.

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Accordingly, the mortgaging of residential house with bank by Mr. Abhishek will not be regarded as a transfer. Therefore, no capital gain will be charged on such transaction.

Further, section 10(43) provides that the amount received by the senior citizen as a loan, either in lump sum or in installment, in a transaction of reverse mortgage would be exempt from income-tax. Therefore, the monthly installment amounts received by Mr. Abhishek would not be taxable.

However, capital gains tax liability would be attracted at the stage of alienation of the mortgaged property by the bank for the purposes of recovering the loan.

Illustration 5

Neerja was carrying on the textile business under a proprietorship concern, Neerja Textiles. On 21.07.2017 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 19.7.2011 for Rs.9,80,000. The company sold the same on 30.03.2018 for Rs.15, 00,000.

Examine the tax implication of the above-mentioned transaction and compute the income chargeable to tax in such case(s).

Solution:

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:

all the assets and liabilities of sole proprietary concern becomes the assets and liabilities of the company.

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 remain as such for a period of 5 years from the date of succession.

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

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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 24 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 Rs.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 × 272/272 **(Refer Note below)**	9,80,000
Long-term capital gain	**5,20,000**

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.2011-12 i.e., 184, 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 Rs.51,304 [Rs.15,00,000 - Rs.14,48,696 (9,80,000 x Rs.272/184)].

Illustration 6

ABC Ltd., converts its capital asset acquired for an amount of Rs.50,000 in June, 2003 into stock-in-trade in the month of November, 2015. The fair market value of the asset on the date of conversion is Rs.4,50,000. The stock-in-trade was sold for an amount of Rs.6,50,000 in the month of September, 2017. What will be the tax treatment?

Financial year	*Cost Inflation Index*
2003-04	*109*
2015-16	*254*
2017-18	*272*

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. 2015-16) but will be taxable only in the year in which the stock-in-trade is sold (i.e. P.Y. 2017-18). Profits from business will also be taxable in the year of sale of the stock-in-trade (P.Y. 2017-18).

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The long-term capital gains and business income for the A.Y.2018-19 are calculated as under:

Particulars	`	`
Profits and Gains from Business or Profession		
Sale proceeds of the stock-in-trade	6,50,000	
Less: Cost of the stock-in-trade (FMV on the date of conversion)	4,50,000	2,00,000
Long Term Capital Gains		
Full value of the consideration (FMV on the date of the conversion)	4,50,000	
Less: Indexed cost of acquisition (` 50,000 x 254/109)	1,16,514	3,33,486

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 7

Ms. Usha purchases 1,000 equity shares in X Ltd., at a cost of Rs.30 per share (brokerage 1%) in January 1996. She gets 100 bonus shares in August 2000. She again gets 1100 bonus shares by virtue of her holding on February 2006. Fair market value of the shares of X Ltd. on April 1, 2001 is Rs.80. In January 2018, she transfers all her shares @ Rs.200 per share (brokerage 2%).

Compute the capital gains taxable in the hands of Ms. Usha for the A.Y. 2018-19

Cost Inflation Index for F.Y. 2001-02: 100, F.Y.2005-06: 117 & F.Y.2017-18: 272.

Solution

Computation of capital gains for the A.Y. 2018-19

Particulars	`
1000 Original shares	
Sale proceeds (1000 × Rs.200)	2,00,000
Less : Brokerage paid (2% of Rs.2,00,000)	4,000
Net sale consideration	1,96,000
Less : Indexed cost of acquisition [Rs.80 × 1000 × 272/100]	2,17,600
Long term capital loss (A)	**(21,600)**
100 Bonus shares	
Sale proceeds (100 × Rs.200)	20,000
Less : Brokerage paid (2% of Rs.20,000)	400

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Net sale consideration	19,600
Less : Indexed cost of acquisition [Rs.80 × 100 ×272/100] [See Note below]	21,760
Long term capital loss (B)	**(2,160)**
1100 Bonus shares	
Sale proceeds (1100 × Rs.200)	2,20,000
Less: Brokerage paid (2% of `2,20,000)	4,400
Net sale consideration	2,15,600
Less: Cost of acquisition	NIL
Long term capital gain (C)	2,15,600
∴ **Long term capital gain (A+B+C)**	**1,91,840**

Note: Cost of acquisition of bonus shares acquired before 1.4.2001 is the FMV as on 1.4.2001 (being the higher of the cost or the FMV as on 1.4.2001).

Illustration 8

On January 31, 2018, Mr. A has transferred self-generated goodwill of his profession for a sale consideration of Rs.70,000 and incurred expenses of Rs.5,000 for such transfer. You are required to compute the capital gains chargeable to tax in the hands of Mr. A for the A.Y. 2018-19.

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.

Illustration 9

Mr. R holds 1000 shares in Star Minus Ltd., an unlisted company, acquired in the year 2001-02 at a cost of Rs.75,000. He has been offered right shares by the company in the month of August, 2017 at Rs.160 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 Rs.30 per share in September 2017. All the shares are sold by Mr. R for Rs.300 per share in January 2018 and Mr. Q sells his shares in December 2017 at Rs.280 per share. What are the capital gains taxable in the hands of Mr. R and Mr. Q?

Financial year	*Cost Inflation Index*
2001-02	*100*
2017-18	*272*

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Computation of capital gains in the hands of Mr. R for the A.Y.2018-19

Particulars	`
1000 Original shares	
Sale proceeds (1000 × `300)	3,00,000
Less : Indexed cost of acquisition [`75,000 × 272/100]	2,04,000
Long-term capital gain (A)	**96,000**
200 Right shares	
Sale proceeds (200 × `300)	60,000
Less : Cost of acquisition [`160 × 200] **[Note 1]**	32,000
Short-term capital gain (B)	**28,000**
Sale of Right Entitlement	
Sale proceeds (200 × `30)	6,000
Less : Cost of acquisition **[Note 2]**	NIL
Short-term capital gain (C)	6,000
Capital Gains (A+B+C)	**1,30,000**

Note 1: Since the holding period of these shares is less than 24 months, 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.2018-19

Particulars	`
Sale proceeds (200 shares × ` 280)	56,000
Less: Cost of acquisition [200 shares × (` 30 + ` 160)] ***[See Note below]***	38,000
Short-term capital gain	**18,000**

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 24 months, they are short term capital assets.

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Illustration 10

X & sons, HUF, purchased a land for Rs.1,20,000 in the P.Y. 2002-03. In the P.Y. 2006-07, a partition takes place when Mr. A, a coparcener, is allotted this plot valued at Rs.1,50,000. In P.Y. 2007-08, he had incurred expenses of Rs.2,35,000 towards fencing of the plot. Mr. A sells this plot of land for Rs.15,00,000 in P.Y. 2017-18 after incurring expenses to the extent of Rs.20,000. You are required to compute the capital gain for the A.Y.2018-19.

Financial year	*Cost Inflation Index*
2002-03	*105*
2006-07	*122*
2007-08	*129*
2017-18	*272*

Solution

Computation of taxable capital gains for the A.Y.2018-19

Particulars	`	`
Sale consideration		15,00,000
Less: Expenses incurred for transfer		20,000
		14,80,000
Less: (i) Indexed cost of acquisition (Rs.1,20,000 ×272/122)	2,67,541	
(ii) Indexed cost of improvement (Rs.2,35,000 ×272/129)	4,95,504	7,63,045
Long term capital gains		**7,16,955**

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 considering the Cost Inflation Index of F.Y.2002-03.

Illustration 11

Mr. B purchased convertible debentures for Rs.5,00,000 during August 2002. The debentures were converted into shares in September 2012. These shares were sold for Rs.15,00,000 in August, 2017. The brokerage expenses are Rs.50,000. You are required to compute the capital gains in case of Mr. B for the assessment year 2018-19.

Financial Year	*Cost Inflation Index*
2002-03	*105*
2012-13	*200*
2017-18	*272*

Solution

Computation of Capital Gains of Mr. B for the A.Y.2018-19

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 (Rs.5,00,000 × 272/105)	12,95,238
Long term capital gain	**1,54,762**

Note: For determining the period of holding of a capital asset, being a share of a company, which becomes the property of the assessee by way of conversion of debentures of that company, the period for which the debenture held by the assesse before conversion shall also be considered.

Illustration 12

Mr. C purchases a house property for Rs.1,06,000 on May 15, 1975. The following expenses are incurred by him for making addition/alternation to the house property:

	Particulars	`
a.	*Cost of construction of first floor in 1982-83*	*3,10,000*
b.	*Cost of construction of the second floor in 2002-03*	*7,35,000*
c.	*Reconstruction of the property in 2012-13*	*5,50,000*

Fair market value of the property on April 1, 2001 is Rs.8,50,000. The house property is sold by Mr. C on August 10, 2017 for Rs.68,00,000 (expenses incurred on transfer: Rs.50,000). Compute the capital gain for the assessment year 2018-19.

Cost Inflation Index: F.Y. 2001-02: 100, F.Y. 2002-03: 105, F.Y. 2012-13: 200, F.Y. 2017-18: 272

Solution: Computation of capital gain of Mr. C for the A.Y.2018-19

Particulars	`	`
Gross sale consideration		68,00,000
Less: Expenses on transfer		50,000
Net sale consideration		67,50,000
Less: Indexed cost of acquisition (Note 1)	23,12,000	
Less: Indexed cost of improvement (Note 2)	26,52,000	49,64,000
Long-term capital gain		**17,86,000**

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Notes:

Indexed cost of acquisition: Rs.8,50,000 × 272/100 = Rs.23,12,000

Fair market value on April 1, 2001 (actual cost of acquisition is ignored as it is lower than market value on April 1, 2001.)

Indexed cost of improvement is determined as under:	`
Construction of first floor in 1982-83 (expenses incurred prior to April 1, 2001 are not considered)	Nil
Construction of second floor in 2002-03 (i.e., `7,35,000 ×272/105)	19,04,000
Alternation/reconstruction in 2012-13 (i.e., `5,50,000 ×272/200)	7,48,000
Indexed cost of improvement	**26,52,000**

Illustration 13

Singhania & Co., a sole proprietorship own six machines, put in use for business in March, 2017. The depreciation on these machines is charged @ 15%. The written down value of these machines as on 1st April, 2017 was Rs.8,50,000. Three of the old machines were sold on 10th June, 2017 for Rs.11,00,000. A new plant was bought for Rs.8,50,000 on 30th November, 2017. You are required to:

(i) Determine the claim of depreciation for Assessment Year 2018-19.

(ii) compute the capital gains liable to tax for Assessment Year 2018-19.

(iii) If Singhania & Co. had sold the three machines in June, 2017 for Rs.21,00,000, will there be any difference in your above workings? Examine.

Solution

(i) Computation of depreciation for A.Y.2018-19

Particulars	`
W.D.V. of the block as on 1.4.2017	8,50,000
Add: Purchase of new plant during the year	8,50,000
	17,00,000
Less: Sale consideration of old machinery during the year	11,00,000
W.D.V of the block as on 31.03.2018	**6,00,000**

Since the value of the block as on 31.3.2018 comprises of a new asset which has been put to use for less than 180 days, depreciation is restricted to 50% of the prescribed percentage of 15% i.e. depreciation is restricted to 7½%. Therefore, the depreciation allowable for the year is Rs.45,000, being 7½% of Rs.6,00,000.

Note: It is assumed that the sole proprietorship is not eligible for additional depreciation under section 32(1)(iia).

(ii) The provisions under section 50 for computation of capital gains in the case of depreciable assets can be invoked only under the following circumstances:

(a) When one or some of the assets in the block are sold for consideration more than the value

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of the block.

(b) When all the assets are transferred for a consideration more than the value of the block.

(c) When all the assets are transferred for a consideration less than the value of the block.

Since in the first two cases, the sale consideration is more than the written down value of the block, the computation would result in short term capital gains.

In the third case, since the written down value exceeds the sale consideration, the resultant figure would be a short-term capital loss.

In the given case, capital gains will not arise as the block of asset continues to exist, and some of the assets are sold for a price which is lesser than the written down value of the block.

(iii) If the three machines are sold in June, 2017 for Rs.21,00,000, then short term capital gains would arise, since the sale consideration is more than the aggregate of the written down value of the block at the beginning of the year and the additions made during the year.

Particulars	`	`
Sale consideration		21,00,000
Less: W.D.V. of the machines as on 1.4.2017	8,50,000	
Purchase of new plant during the year	8,50,000	17,00,000
Short term capital gains		**4,00,000**

Illustration 14

Mr. A is a proprietor of Akash Enterprises having 2 units. He transferred on 1.4.2017 his Unit 1 by way of slump sale for a total consideration of Rs.25 lacs. Unit 1 was started in the year 2004-05. The expenses incurred for this transfer were Rs.28,000. His Balance Sheet as on 31.3.2017 is as under:

Liabilities	Total (`)	Assets	Unit 1(`)	Unit 2 (`)	Total (`)
Own Capital	15,00,000	Building	12,00,000	2,00,000	14,00,000
Revaluation Reserve (for building of unit 1)	3,00,000	Machinery	3,00,000	1,00,000	4,00,000
Bank loan (70% for unit 1)	2,00,000	Debtors	1,00,000	40,000	1,40,000
Trade creditors (25% for unit 1)	1,50,000	Other assets	1,50,000	60,000	2,10,000
Total	**21,50,000**	**Total**	**17,50,000**	**4,00,000**	**21,50,000**

Other information:

(i) Revaluation reserve is created by revising upward the value of the building of Unit 1.

(ii) No individual value of any asset is considered in the transfer deed.

(iii) Other assets of Unit 1 include patents acquired on 1.7.2015 for Rs.50,000 on which no depreciation has been charged.

Compute the capital gain for the assessment year 2018-19.

Solution:

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Computation of capital gains on slump sale of Unit 1

Particulars	`
Sale value	25,00,000
Less: Expenses on sale	28,000
Net sale consideration	24,72,000
Less: Net worth **(See Note 1 below)**	12,50,625
Long-term capital gain	**12,21,375**

Notes:

1. Computation of net worth of Unit 1 of Akash Enterprises

Particulars	`	`
Building (excluding ` 3 lakhs on account of revaluation)		9,00,000
Machinery		3,00,000
Debtors		1,00,000
Patents **(See Note 2 below)**		28,125
Other assets (` 1,50,000 – ` 50,000)		1,00,000
Total assets		14,28,125
Less: Creditors	37,500	
Bank Loan	1,40,000	1,77,500
Net worth		**12,50,625**

2. Written down value of patents as on 1.4.2017

Value of patents:	`
Cost as on 1.7.2015	50,000
Less: Depreciation @ 25% for Financial Year 2015-16	12,500
WDV as on 1.4.2016	37,500
Less: Depreciation for Financial Year 2016-17	9,375
WDV as on 1.4.2017	**28,125**

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For the purposes of computation of net worth, the written down value determined as per section 43(6) has to be considered in the case of depreciable assets. The problem has been solved assuming that the Balance Sheet values of Rs.3 lakh and Rs.9 lakh (Rs.12 lakh – Rs.3 lakh) represent the written down value of machinery and building, respectively, of Unit 1.

3. Since the Unit is held for more than 36 months, capital gain arising would be long term capital gain. However, indexation benefit is not available in case of slump sale.

Illustration 15

Mr. Kay purchases a house property on April 10, 1992 for Rs.65,000. The fair market value of the house property on April 1, 2001 was Rs.2,70,000. On August 31, 2003, Mr. Kay enters into an agreement with Mr. Jay for sale of such property for Rs.3,70,000 and received an amount of Rs.60,000 as advance. However, as Mr. Jay did not pay the balance amount, Mr. Kay forfeited the advance. In May 2008, Mr. Kay constructed the first floor by incurring a cost of Rs.2,35,000. Subsequently, in January2009, Mr. Kay gifted the house to his friend Mr. Dee. On February 10, 2018, Mr. Dee sold the house for Rs.12,00,000.

CII for F.Y. 2003-04: 109; 2008-09: 137; 2017-18: 272.

Compute the capital gains in the hands of Mr. Dee for A.Y.2018-19.

Solution

Computation of taxable capital gains of Mr. Dee for A.Y.2018-19

Particulars	`	`
Sale consideration		12,00,000
Less: Indexed cost of acquisition (See Note below)	5,36,058	
Indexed cost of improvement (See Note below)	4,66,569	10,02,627
Long-term capital gain		**1,97,373**

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 January2009 (P.Y. 2008-09) to February, 2018 (P.Y. 2017-18).

Indexed cost of acquisition = (Rs.2,70,000 × 272/137) = Rs.5,36,058

Indexed cost of improvement = (Rs.2,35,000 × 272/137) =

Rs.4,66,569

Amount forfeited by previous owner, Mr. Kay, shall not be deducted from cost of acquisition.

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

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DT QUESTION BANK BY YNB

of acquisition would have to be calculated by taking the CII of F.Y.2001-02, since the Fair Market Value as on 1.4.2001 has been taken as the cost of acquisition.

Illustration 16

Mr. X purchases a house property in December 1993 for Rs.5,25,000 and an amount of Rs.1,75,000 was spent on the improvement and repairs of the property in March, 1997. The property was proposed to be sold to Mr. Z in the month of May, 2006 and an advance of Rs.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, 2018 for Rs.52,00,000. The fair value of the property on April 1, 2001 was Rs.11,90,000. What is the capital gain chargeable in the hands of Mr. X for the A.Y. 2018-19?

Financial year	*Cost Inflation Index*
2001-02	*100*
2006-07	*122*
2017-18	*272*

Solution

Capital gains in the hands of Mr. X for the A.Y.2018-19 is computed as under:

Particulars	`
Sale proceeds	52,00,000
Less : Indexed cost of acquisition **[Note 1]**	31,28,000
Indexed cost of improvement **[Note 2]**	-
Long term capital gains	**20,72,000**

Note 1: Computation of indexed cost of acquisition

Cost of acquisition (higher of fair market value as on April 1, 2001 and the actual cost of acquisition)	11,90,000
Less : Advance taken and forfeited	40,000
Cost for the purposes of indexation	11,50,000
Indexed cost of acquisition (` 11,50,000 x 272/100)	31,28,000

Note 2: Any improvement cost incurred prior to 1.4.2001 is to be ignored when fair market value as on 1.4.2001 is taken into consideration.

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Illustration 17

Mr. Kumar has an agricultural land (costing Rs.6 lakh) in Lucknow and has been using it for agricultural purposes since 1.4.2000 till 1.8.2011 when the Government took over compulsory acquisition of this land. A compensation of Rs.10 lakh was settled. The compensation was received by Mr. Kumar on 1.7.2017. 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.2018-19.

Illustration 18

Will your answer be any different if Mr. Kumar had by his own will sold this land to his friend Mr. Sharma? Examine.

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 19

Will your answer be different if Mr. Kumar had not used this land for agricultural activities? Examine.

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 20

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? Examine.

Solution

Section 10(37) exempts capital gains arising to an individual or a HUF from transfer of agricultural land by way of compulsory acquisition. If 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.

Illustration 21

Mr. Cee purchased a residential house on July 20, 2015 for Rs.10,00,000 and made some additions to the house incurring Rs.2,00,000 in August 2015. He sold the house property in April 2017 for Rs.20,00,000. Out of the sale proceeds, he spent ` 5,00,000 to purchase another house

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property in September 2017.

What is the amount of capital gains taxable in the hands of Mr. Cee for the A.Y. 2018-19?

Solution

The house is sold before 24 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 Rs.8,00,000.

Illustration 22

PQR Ltd., purchased a land for industrial undertaking in May 2003, at a cost of Rs.4,00,000. The above property was compulsorily acquired by the State Government at a compensation of Rs.12,00,000 in the month of January, 2018. The compensation was received in March, 2018. The company purchased another land for its industrial undertaking at a cost of Rs.2,00,000 in the month of March, 2018. What is the amount of the capital gains chargeable to tax in the hands of the company for the A.Y. 2018-19?

Financial year	Cost Inflation Index
2003-04	109
2017-18	272

Solution

Computation of capital gains in the hands of PQR Ltd. for the A.Y.2018-19

Particulars	`
Sale proceeds (Compensation received)	12,00,000
Less : Indexed cost of acquisition [` 4,00,000 × 272/109]	9,98,165
	2,01,835
Less: Exemption under section 54D (Cost of acquisition of new undertaking)	2,00,000
Taxable long term capital gain	**1,835**

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Illustration 23

Capital gain of `75 lakh arising from transfer of long term capital assets on 1.5.2017 will be exempt from tax if such capital gain is invested in the bonds redeemable after three years, issued by NHAI under section 54EC. Examine with reasons whether the given statement is true or false having regard to the provisions of the Income-tax Act, 1961.

Solution

False: The exemption under section 54EC has been restricted, by limiting the maximum investment in long term specified assets (i.e. bonds of NHAI or RECL or any other bond notified by Central Government in this behalf, redeemable after 3 years) to Rs.50 lakh, whether such investment is made during the relevant previous year or the subsequent previous year, or both. Therefore, in this case, the exemption under section 54EC can be availed only to the extent of `50 lakh, provided the investment is made before 1.11.2017 (i.e., within six months from the date of transfer).

Illustration 24

From the following particulars, compute the taxable capital gains of Mr. D for A.Y.2018-19 -

Particulars	*Amount (`)*
Cost of jewellery [Purchased in F.Y.2004-05]	*4,52,000*
Sale price of jewellery sold in January 2018	*11,50,000*
Expenses on transfer	*7,000*
Residential house purchased in March 2018	*5,00,000*

The cost inflation Index are as follows:

Financial Year	*Cost Inflation Index*
2004-05	*113*
2017-18	*272*

Solution

Computation of taxable capital gains for A.Y.2018-19

Particulars	`
Gross consideration	11,50,000
Less: Expenses on transfer	7,000
Net consideration	11,43,000
Less: Indexed cost of acquisition (Rs.4,52,000 × 272/113)	10,88,000

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	55,000
Less: Exemption under section 54F (` 55,000 × ` 5,00,000/` 11,43,000)	24,059
Taxable capital gains	**30,941**

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 the capital gain exempted earlier under section 54F would be taxable as long-term capital gains.
- In the given illustration, if the new residential house is sold for Rs.6,00,000 after say, 1 year, then
  - Rs.1,00,000 [i.e. Rs.6,00,000 (-) Rs.5,00,000] would be chargeable as short-term capital gain of that year in which the new house is sold.

    Note – In case the new residential house is sold after 2 years, the capital gains would be long-term capital gains
  - Rs.24,059, being the capital gains exempt earlier, would be taxable as long-term capital gains of that year in which the new house is sold.

Illustration 25

Mr. Akash sold his residential property on 2nd February, 2018 for Rs.90 lakh and paid brokerage@1% of sale price. He had purchased the said property in May 2001 for Rs.24,36,000. In June, 2018, he invested Rs.75 lakh in equity of A (P) Ltd., an eligible start-up 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 2018 – Rs.65 lakh

(b) Included in (a) above are Rs.6 lakh for purchase of computers and Rs.8 lakh for purchase of cars.

(c) Air-conditioners purchased for Rs.1 lakh, included in the (a) above, were installed at the residence of Mr. Akash.

(d) Amount deposited in specified bank on 28.9.2018 – Rs.10 lakh

Compute the chargeable capital gain for the A.Y.2018-19. Assume that Mr. Akash is liable to file his return of income on or before 30th September, 2018 and he files his return on 29.09.2018.

Solution

Computation of taxable capital gains for A.Y.2018-19

Particulars	`
Gross consideration	90,00,000

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Less: Expenses on transfer (1% of the gross consideration)	90,000
Net consideration	89,10,000
Less: Indexed cost of acquisition (` 24,36,000 × 272/100)	66,25,920
	22,84,080
Less: Exemption under section 54GB (` 22,84,080 × `66,00,000 /` 89,10,000)	16,91,911
Taxable capital gains	**5,92,169**

Deemed cost of new plant and machinery for exemption under section 54GB

	Particulars	`	`
(1)	Purchase cost of new plant and machinery acquired in July, 2018		65,00,000
	Less: Cost of vehicles, i.e., cars	8,00,000	
	Cost of air-conditioners installed at the residence of Mr. Akash	1,00,000	9,00,000
			56,00,000
(2)	Amount deposited in the specified bank before the due date of filing of return		10,00,000
Deemed cost of new plant and machinery for exemption under section 54GB			**66,00,000**

Illustration 26

Calculate the income-tax liability for the assessment year 2018-19 in the following cases:

	Mr. A (age 45)	*Mrs. B (age 62)*	*Mr. C (age 81)*	*Mr. D (age 82)*
Status	*Resident*	*Non- resident*	*Resident*	*Non-resident*
Total income other than long-term capital gain	*2,40,000*	*2,80,000*	*5,90,000*	*4,80,000*
Long-term capital gain	*15,000 from sale of vacant site*	*10,000 from sale of listed shares (STT paid on sale and purchase of shares)*	*60,000 from sale of agricultural land in rural area*	*Nil*

Solution

Computation of income-tax liability for the A.Y.2018-19

Particulars	Mr. A (age 45)	Mrs. B (age 62)	Mr. C (age 81)	Mr. D (age 82)
Residential Status	**Resident**	**Non-resident**	**Resident**	**Non-resident**
Applicable basic exemption limit	` 2,50,000	` 2,50,000	` 5,00,000	` 2,50,000
Asset sold	Vacant site	Listed shares (STT paid at both sale and purchase of shares)	Rural agricultural land	-
Long-term capital gain (on sale of above asset)	` 15,000 [Taxable@20% u/s 112]	` 10,000 [exempt u/s 10(38)]	` 60,000 (Exempt – not a capital asset)	-
Other income	Rs.2,40,000	Rs.2,80,000	Rs.5,90,000	Rs.4,80,000
Tax liability				
On LTCG (after adjusting Basic Exemption limit)	Rs.1,000	-	-	-
On Other income	Rs.Nil	Rs.1,500	Rs.18,000	Rs.11,500
Less: Rebate u/s 87A	Rs.1,000 Rs.1,000 Rs.Nil	Rs.1,500	Rs.18,000	Rs.11,500
Add: Education cess @2% & SHEC @1%	Nil	Rs.45	Rs.540	Rs.345
Total tax liability	**Rs.Nil**	**Rs.1,545**	**Rs.18,540**	**Rs.11,845**

Notes:

1. Since Mrs. B and Mr. D are non-residents, they cannot avail the higher basic exemption limit of Rs.3,00,000 and Rs.5,00,000 for persons over the age of 60 years and 80 years, respectively.
2. Since Mr. A is a resident whose total income does not exceed Rs.3.5 lakhs, he is eligible for rebate of Rs.2,500 or the actual tax payable, whichever is lower, under section 87A
3.

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EXERCISE

Question 1

Hari has acquired a residential house property in Delhi on 15th April, 2001 for Rs.10,00,000 and decided to sell the same on 3rd May, 2004 to Ms. Pari and an advance of Rs.25,000 was taken from her. The balance money was not paid by Ms. Pari and Hari has forfeited the entire advance sum. On 3rd June, 2017, he has sold this house to Mr. Suri for Rs.35, 00,000. In the meantime, on 4th April, 2017, he had purchased a residential house in Delhi for Rs.8,00,000, where he was staying with his family on rent for the last 5 years and paid the full amount as per the purchase agreement. However, Hari does not possess any legal title till 31st March, 2018, as such transfer was not registered with the registration authority.

Hari has purchased another old house in Chennai on 14th October, 2017 from Mr. X, an Indian resident, by paying Rs.5,00,000 and the purchase was registered with the appropriate authority.

Determine the taxable capital gain arising from above transactions in the hands of Hari for Assessment Year 2018-19 [Cost inflation Index - 2001-02: 100; 2004-05: 113; 2017-18: 272]

Answer

Computation of taxable capital gain of Mr. Hari for the A.Y.2018-19

Particulars	`
Sale proceeds	35,00,000
Less: Indexed cost of acquisition **(See Note 1)**	26,52,000
Long Term Capital Gain	8,48,000
Less: Exemption under section 54 in respect of investment in house at Delhi **(See Note 2)**	8,00,000
Taxable long-term capital gain	**48,000**

Notes:

1. Computation of indexed cost of acquisition

Particulars	`
Cost of acquisition	10,00,000
Less: Advance taken and forfeited	25,000
Cost for the purpose of Indexation	9,75,000
Indexed cost of acquisition (` 9,75,000 x 272/100)	26,52,000

Note: Advance received and forfeited on or after 01.04.2014 is taxable under section 56(2)(ix). Such amount would not be reduced to compute indexed cost of acquisition while determining capital gains on sale of such property.

However, in this case, since the advance was received and forfeited in the year 2004, such

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advance has to be reduced for calculating indexed cost of acquisition for the purpose of arriving at capital gains.

2. In order to avail exemption of capital gains under section 54, a 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 this case, Hari has purchased the residential house in Delhi within one year before the date of transfer and paid the full amount as per the purchase agreement, though he does not possess any legal title till 31.3.2018 since the transfer was not registered with the registration authority. However, for the purpose of claiming exemption under section 54, holding of legal title is not necessary. If the taxpayer pays the full consideration in terms of the purchase agreement within the stipulated period, the exemption under section 54 would be available. It was so held in Balraj v. CIT(2002) 254 ITR 22 (Del.) and CIT v. Shahzada Begum (1988) 173 ITR 397 (A.P.).

3 Section 54 provides that exemption thereunder can be availed in respect of investment made in **one residential house** situated in India. It would be more beneficial for Mr. Hari to claim exemption in respect of the Delhi house since the cost of the same is higher than the cost of the Chennai house.

Question 2

The proprietary firm of "Mr. Amolak" a practicing Chartered Accountant, was converted into partnership on 01.09.2017 when his son joined him in the firm for 50% share. All the assets and liabilities of the erstwhile proprietary firm were transferred into the newly constituted partnership firm.

"Mr. Amolak" was credited and paid an amount of Rs.5 lacs in his account from the firm. Explain as to chargeability of this amount of Rs.5 lacs in the hands of "Mr. Amolak" when it stands paid for:

(i) transfer of business into partnership;

(ii) goodwill by the incoming partner.

Answer

(i) If the amount was paid for transfer of business / profession to partnership

As per section 45(3), the profits and gains arising from the transfer of a capital asset by a person to the firm in which he becomes a partner shall be chargeable to tax as the income of the previous year which such transfer takes place. The amount recorded in the books of account of the firm would be deemed to be the full value of consideration received or accruing as a result of transfer of the capital asset.Since in this case, consideration of Rs.5 lacs **is received for such transfer**, profit or gain accrues to the transferor for the purposes of section 45. The amount of Rs.5 lacs would be the full value of consideration received as a result of transfer and the capital gains resulting from this transfer would be chargeable to tax.

(ii) If the amount is paid by the incoming partner for Goodwill

The Supreme Court, in CIT v. B.C. Srinivasa Setty (1981) 128 ITR 294, observed that the income chargeable to capital gains tax is to be computed by deducting from the full value of consideration "the cost of acquisition of the capital asset". If it is not possible to ascertain the cost of acquisition, then, transfer of such asset is not chargeable to tax.

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Section 55(2)(a) provides that the cost of acquisition of certain self-generated assets, including goodwill of a business, is Nil. Therefore, in respect of these self-generated assets covered under section 55(2)(a), the decision of the Supreme Court in B.C. Srinivasa Setty's case would not apply. However, in respect of other self-generated assets, including goodwill of profession, the decision of the Supreme Court in B.C. Srinivasa Setty's case, would continue to be applicable.

In effect, in case of self-generated assets not covered under section 55(2)(a), since the cost is not ascertainable, there would be no capital gains tax liability.

Therefore, in this case, since the consideration of Rs.5lakhs is paid towards goodwill of a profession, whose cost is **NOT** to be taken as 'Nil' since it is not covered under section 55(2)(a), the liability to capital gains tax will not arise.

Question 3

Mr. Ganesh sold his residential house in Mumbai and purchased two residential flats adjacent to each other on the same day vide two separate registered sale deeds from two different persons. The builder had certified that he had effected necessary modification to make it one residential apartment. Mr. Ganesh sought exemption under section 54 in respect of the investment made in purchase of the two residential flats. The Assessing Officer, however, gave exemption under section 54 to the extent of purchase of one residential flat only contending that sub-section (1) of section 54 clearly restricts the benefit of exemption to purchase one residential house only and the two flats cannot be treated as one residential unit since –

(i) the flats were purchased through different sale deeds; and

(ii) it was found by the Inspector that, before its sale to the assessee, the residential flats were in occupation of two different tenants.

Examine the correctness of the contention of the Assessing Officer.

Answer

This issue came up before the Karnataka High Court in CIT v. D. Ananda Basappa (2009) 309 ITR 329. The Court observed that the assessee had shown that the flats were situated side by side and the builder had also certified that he had effected modification of the flats to make them one unit by opening the door between the apartments. Therefore, it was immaterial that the flats were occupied by two different tenants prior to sale or that it was purchased through different sale deeds. The Court observed that these were not the grounds to hold that the assessee did not have the intention to purchase the two flats as one unit. The Court held that the assessee was entitled to exemption under section 54 in respect of purchase of both the flats to form one residential house.

Applying the ratio of the above decision to the case on hand, Mr. Ganesh is entitled to exemption under section 54 in respect of purchase of two flats to form **one residential house**. Therefore, the contention of the Assessing Officer is not correct.

Question 4

Vijay, an individual, owned three residential houses which were let out. Besides, he and his four brothers co-owned a residential house in equal shares. He sold one residential house owned by him during the previous year relevant to the assessment year 2018-19. Within a month from the date of

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such sale, the four brothers executed a release deed in respect of their shares in the co-owned residential house in favour of Vijay for a monetary consideration.

Vijay utilised the entire long-term capital gain arising out of the sale of the residential house for payment of the said consideration to his four brothers. Vijay is not using the house, in respect of which his brothers executed a release deed, for his own residential purposes, but has let it out to another person, who is using it for his residential purposes.

Is Vijay eligible for exemption under section 54 of the Income-tax Act, 1961 for the assessment year 2018-19 in respect of the long-term capital gain arising from the sale of his residential house, which he utilised for acquiring the shares of his brothers in the co-owned residential house? Will the non- use of the new house for his own residential purposes disentitle him to exemption?

Answer

The long-term capital gain arising on sale of residential house would be exempt under section 54 if it is utilized, inter alia, for purchase of one residential house situated in India within one year before or two years after the date of transfer. Release by the other co-owners of their share in co-owned property in favour of Vijay would amount to "purchase" by Vijay for the purpose of claiming exemption under section 54 [CIT v. T.N. Arvinda Reddy (1979) 120 ITR 46 (SC)]. Since such purchase is within the stipulated time of two years from the date of transfer of asset, Vijay is eligible for exemption under section 54. As Vijay has utilised the entire long-term capital gain arising out of the sale of the residential house for payment of consideration to the other co-owners who have released their share in his favour, he can claim full exemption under section 54.

There is no requirement in section 54 that the new house should be used by the assessee for his own residence. The condition stipulated is that the new house should be utilised for residential purposes and its income is chargeable under the head "Income from house property". This requirement would be satisfied even when the new house is let out for residential purposes.

Question 5

Aries Tubes Private Ltd. went into liquidation on 01.06.2017. The company was seized and possessed of the following funds prior to the distribution of assets to the shareholders:

	`
Share Capital (issued on 01.04.2012)	*5,00,000*
Reserves prior to 1.6.2017	*3,00,000*
Excess realization in the course of liquidation	*5,00,000*
Total	***13.00.000***

There are 5 shareholders, each of whom received Rs.2,60,000 from the liquidator in full settlement. The shareholders desire to invest the resultant element of capital gains in long-term specified assets as defined in section 54EC. You are required to examine the various issues and advice the shareholders about their liability to income tax.

Answer

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Under section 46(1), where the assets of a company are distributed to its shareholders on its liquidation, such distribution shall not be regarded as transfer in the hands of the company for the purpose of section 45.

However, under section 46(2), where the shareholder, on liquidation of a company, receives any money or other assets from the company, he shall be chargeable to income-tax under the head "capital gains", in respect of the money so received or the market value of the other assets on the date of distribution as reduced by the amount of dividend deemed under section 2(22)(c) and the sum so arrived at shall be deemed to be the full value of the consideration for the purposes of section 48.

As per section 2(22)(c), dividend includes 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 capitalized or not.

In this case, the accumulated profits immediately before liquidation is Rs.3,00,000. The share of each shareholder is Rs.60,000 (being one-fifth of Rs.3,00,000). An amount of Rs.60,000 is the deemed dividend under section 2(22)(c). The same is exempt under section 10(34) in the hands of the shareholder, since the company is liable to dividend distribution tax in respect of the same[4].

Therefore, Rs.2,00,000 [i.e. Rs.2,60,000 minus Rs.60,000, being the deemed dividend under section 2(22)(c)] is the full value of consideration in the hands of each shareholder as per section 46(2). Against this, the investment of Rs.1,00,000 by each shareholder is to be deducted to arrive at the capital gains of Rs.1,00,000 of each shareholder. The benefit of indexation is available to the shareholders (since the shares are held for more than 24 months and hence long-term capital asset), but could not be computed in the absence of required information. Since the equity shares are not listed, it would not be liable for securities transaction tax and hence, the capital gain (long term) is not exempt under section 10(38). The benefit of concessional rate of tax @10% without indexation would also not be available. Hence, such long term capital gain would be taxable @ 20% with indexation benefit.

Exemption under section 54EC is available only where there is an actual transfer of capital assets and not in the case of deemed capital gain as per the decision rendered in the case of CIT v. Ruby Trading Co (P) Ltd (2003) 259 ITR 54 (Raj). Therefore, exemption under section 54EC will not be available in this case since it is deemed transfer and not actual transfer.

Note: However, in case a view is taken that on liquidation of a company, the shareholders right in the said company is relinquished or extinguished and the consideration received by the shareholder is for such relinquishment or extinguishment of rights of the shareholder, then, this transaction shall be transfer as per section 2(47) and the exemption under section 54EC in respect of the capital gain arising from the said transaction shall be available.

Question 6

Xavier had taken a loan under registered mortgage deed against the house, which was purchased by him on 26.05.2001 for Rs.5 lacs. The said property was inherited by his son Abraham in financial year 2008-09 as per Will.

For obtaining a clear title thereof, Abraham paid the outstanding amount of loan on 12.02.2009 of Rs.15 lacs. The said house property was sold by Abraham on 16.03.2018 for Rs.50 lacs. Examine

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with reasons the amount chargeable to capital gains for A.Y. 2018-19

(Cost Inflation Index 2001-02: 100, 2008-09: 137 and 2017-18: 272).

Answer

The cost of inherited property to Mr. Abraham shall be the cost to the previous owner as per provisions of section 49(1)(iiia) and therefore, Rs.5 lacs, being the cost to his father (amount paid by his father on 26.5.2001 for acquiring the property) shall be the cost to Mr. Abraham, who is the new owner. Payment of outstanding loan of the predecessor by the successor for obtaining a clear title

[4] It is assumed that shareholders have received dividend only from Aries Tubes Private Ltd., a domestic company during the previous year 2017-18.

of the property by release of Mortgage Deed shall be the cost of acquisition of the successor under section 48 read with section 55(2) of the Act as held by the Apex Court in case of RM. Arunachalam v. CIT [1997] 227 ITR 222.

Computation of Taxable Capital Gain for the A.Y. 2018-19

Particulars		`
Sale consideration of house property		50,00,000
Less: **Indexed cost of acquisition (See Note below)**		
(i) Cost to previous owner (` 5,00,000 × 272 / 137)	9,92,701	
(ii) Loan amount paid by Mr. Abraham (Benefit of CII is available since the loan amount was paid in the financial year 2008-09) (` 15,00,000 × 272/137)	29,78,102	39,70,803
Capital gains		**10,29,197**

Note: Since the property was acquired by Mr. Abraham through inheritance, the cost of acquisition will be cost to the previous owner.

As per the definition of indexation cost of acquisition under clause (iii) of Explanation below section 48, indexation benefit will be available only from the previous year in which Abraham first held the asset i.e. P.Y. 2008-09.

However, as per the view expressed by Bombay High Court, in the case of CIT v. Manjula J. Shah (2013) 355 ITR 474, 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 be Rs.43,38,102 and long term capital gain would be Rs.6,61,898.

Question 7

Gama Ltd, located within the corporation limits decided in December, 2017 decided to shift its industrial

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undertaking to non-urban area. The company sold some of the assets and acquired new assets in the process of shifting. The relevant details are as follows:

		(` in lacs)			
	Particulars	**Land**	**Building**	**Plant & Machinery**	**Furniture**
(i)	*Sale proceeds (sale effected in March, 2018)*	8	18	16	3
(ii)	*Indexed cost of acquisition*	4	10	12	2
(iii)	*Cost of acquisition in terms of section 50*	--	4	5	2
(iv)	*Cost of new assets purchased in July, 2018 for the purpose of business in the new place*	4	7	17	2

Compute the capital gains of Gama Ltd for the assessment year 2018-19.

Answer

Section 54G deals with deduction in respect of any capital gain that may arise from the transfer of an industrial undertaking situated in an urban area in the course of or in consequence of shifting to a non-urban area.

If the assessee purchases new machinery or plant or acquires a building or land or constructs a new building or shifts the original asset and transfers the establishment to the new area, within 1 year before or 3 years after the date on which the transfer takes place, then, instead of the capital gain being charged to tax, it shall be dealt with as under:

1. If the capital gain is greater than the cost of the new asset, the difference between the capital gain and the cost of the new asset shall be chargeable as income 'under section 45'.

2. If the total gain is equal to or less than the cost of the new asset, section 45 is not to be applied.

The capital assets referred to in section 54G are machinery or plant or land or building or any rights in building or land. Capital gain arising on transfer of furniture does not qualify for exemption under section 54G. No exemption is therefore available under section 54G in respect of investment of Rs.2 lacs in acquiring furniture.

The first step therefore is to determine the capital gain arising out of the transfer and thereafter applies the provisions of section 54G.

	Particulars	`
(a)	**Land** – Sale proceeds (Non-depreciable asset)	8,00,000
	Less: Indexed cost of acquisition	4,00,000

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	Long term capital gain	4,00,000
	Less: Cost of new assets purchased within three year after the date of transfer (under section 54G)	3,00,000
	Taxable Long term capital gain	**1,00,000**
(b)	**Building** – sale proceeds (depreciable assets)	18,00,000
	Less: W.D.V. is deemed as cost of acquisition under section 50	4,00,000
	Short term capital gain	**14,00,000**
(c)	**Plant & machinery-** sale proceeds (depreciable asset)	16,00,000
	Less: WDV is deemed cost under section 50	5,00,000
	Short term capital gain	**11,00,000**
(d)	**Furniture -** sale proceeds (depreciable asset)	3,00,000
	Less: WDV is deemed cost under section 50	2,00,000
	Short term capital gain **(A)**	**1,00,000**
	Summary	
Short term capital gain : Building		14,00,000
Short term capital gain : Plant & machinery		11,00,000
		25,00,000
Less: Section 54G [New assets purchased] **(See Note below)**		25,00,000
Net short term capital gain **(B)**		**Nil**
Total short term capital gain (A)+(B) = Rs.1 lac		

Note – Total exemption available under section 54G is Rs.28 lacs (Rs.4 lacs + Rs.7 lacs + Rs.17 lacs). The exemption should first be exhausted against short term capital gain as the incidence of tax in case of short-term capital gain is more than in case of long term capital gain. Therefore, Rs.25 lacs are exhausted against short term capital gain and the balance of Rs.3 lacs against long term capital gain.

The taxable capital gains would be:

Long term capital gains	Rs.1,00,000 (taxable @ 20% under section 112)
Short term capital gains (furniture)	Rs.1,00,000 (taxable @30%)
	Rs.2,00,000

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Question 8

The assessee was a company carrying on business of manufacture and sale of art-silk cloth. It purchased machinery worth Rs.4 lacs on 1.5.2007 and insured it with United India Assurance Ltd against fire, flood, earthquake etc., The written down value of the asset as on 01.04.2017 was Rs.2,08,800. The insurance policy contained a reinstatement clause requiring the insurance company to pay the value of the machinery, as on the date of fire etc., in case of destruction of loss. A fire broke out in August, 2017 causing extensive damage to the machinery of the assessee rendering them totally useless. The assessee company received a sum of Rs.6 lacs from the insurance company on 15th March, 2018. Discuss the issues arising on account on the transactions and their tax treatment.

(Cost inflation index for financial year 2007-08 and 2017-18 are 129 and 272 respectively)

Answer

As per section 45(1A), where any person receives any money or other assets under an insurance from an insurer on account of damage to or destruction of capital asset, then, any profits and gains arising from the receipt of such money or other assets, shall be chargeable to income tax under the head "Capital Gains" and shall be deemed to be the income of such person of the previous year in which such money or asset was received.

For the purpose of section 48, the money received or the market value of the asset shall be deemed to be the full value of the consideration accruing as a result of the transfer of such capital asset. Since the asset was destroyed and the money from the insurance company was received in the previous year, there will be a liability to capital gains in respect of the insurance moneys received by the assessee.

Under section 45(1A) any profits and gains arising from receipt of insurance moneys is chargeable under the head "Capital gains". For the purpose of section 48, the moneys received shall be deemed to be the full value of the consideration accruing or arising. Under section 50 the capital gains in respect of depreciable assets had to be computed in the following manner (**assuming it was the only asset in the block**).

The computation of capital gain and tax implication is given below:

Full value of the consideration	Rs.6,00,000
Less: Written down value as on April 1st, 2017	Rs.2,08,800
Short term capital gains	Rs.3,91,200

Question 9

Tani purchased a land at a cost of Rs.35 lakhs in the financial year 2003-04 and held the same as her capital asset till 31st March, 2011. Tani started her real estate business on 1st April, 2011 and converted the said land into stock-in-trade of her business on the said date, when the fair market value of the land was Rs.210 lakhs. She constructed 15 flats of equal size, quality and dimension. Cost of construction of each flat is Rs.10 lakhs. Construction was completed in January, 2018. She sold 10 flats at Rs. 30 lakhs per flat between January, 2018 and March, 2018. The remaining 5 flats were held

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in stock as on 31st March, 2018. She invested Rs.50 lakhs in bonds issued by National Highway Authority of India on 31st March, 2018 and another Rs.50 lakhs in bonds of Rural Electrification Corporation Ltd. in April, 2018.Compute the amount of chargeable capital gain and business income in the hands of Tani arising from the above transactions for Assessment Year 2018-19 indicating clearly the reasons for treatment for each item. Cost Inflation Index: FY 2003-04: 109; FY 2011-12: 184; FY 2017-18: 272.

Answer

Computation of capital gains and business income of Tani for A.Y. 2018-19

Particulars	`
Capital Gains	
Fair market value of land on the date of conversion deemed as the full value of consideration for the purposes of section 45(2)	2,10,00,000
Less: Indexed cost of acquisition [Rs.35,00,000 × 184/109]	59,08,257
	1,50,91,743
Proportionate capital gains arising during A.Y.2018-19 [`1,50,91,743 × 2/3]	1,00,61,162
Less: Exemption under section 54EC	50,00,000
Capital gains chargeable to tax for A.Y.2018-19	50,61,162
Business Income	
Sale price of flats [10 × Rs.30 lakhs]	3,00,00,000
Less: Cost of flats	
Fair market value of land on the date of conversion [Rs.210 lacs × 2/3]	1,40,00,000
Cost of construction of flats [10 × Rs.10 lakhs]	1,00,00,000
Business income chargeable to tax for A.Y.2018-19	**60,00,000**

Notes:

(1) The conversion of a capital asset into stock-in-trade is treated as a transfer under section 2(47). It would be treated as a transfer in the year in which the capital asset is converted into stock- in-trade.

(2) However, as per section 45(2), the capital gains arising from the transfer by way of conversion of capital assets into stock-in-trade will be chargeable to tax only in the year in which the stock- in-trade is sold.

(3) The indexation benefit for computing indexed cost of acquisition would, however, be available only up to the year of conversion of capital asset to stock-in-trade and not up to the year of sale of stock-in-trade.

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(4) For the purpose of computing capital gains in such cases, the fair market value of the capital asset on the date on which it was converted into stock-in-trade shall be deemed to be the full value of consideration received or accruing as a result of the transfer of the capital asset.

In this case, since only 2/3rd of the stock-in-trade (10 flats out of 15 flats) is sold in the P.Y.2017-18, only proportionate capital gains (i.e., 2/3rd) would be chargeable in the A.Y.2018-19.

(5) On sale of such stock-in-trade, business income would arise. The business income chargeable to tax would be computed after deducting the fair market value on the date of conversion of the capital asset into stock-in-trade and cost of construction of flats from the price at which the stock-in-trade is sold.

(6) In case of conversion of capital asset into stock-in-trade and subsequent sale of stock-in-trade, the period of 6 months is to be reckoned from the date of sale of stock-in-trade for the purpose of exemption under section 54EC [CBDT Circular No.791 dated 2.6.2000]. In this case, since the investment in bonds of NHAI has been made within 6 months of sale of flats, the same qualifies for exemption under section 54EC. With respect to long-term capital gains arising in any financial year, the maximum deduction under section 54EC would be Rs.50 lakhs, whether the investment in bonds of NHAI or RECL are made in the same financial year or next financial year or partly in the same financial year and partly in the next financial year.

Therefore, even though investment of Rs.50 lakhs has been made in bonds of NHAI during the P.Y.2017-18 and investment of Rs.50 lakhs has been made in bonds of RECL during the P.Y.2018-19, both within the stipulated six month period, the maximum deduction allowable for A.Y.2018-19, in respect of long-term capital gain arising on sale of long-term capital asset(s) during the P.Y.2017-18, is only Rs.50 lakhs.

Question 10

Mr. Shakti purchased a residential house in March, 2002 for Rs.22 lakhs. He sold the house on 1st December, 2017 for Rs.100 lakhs. He paid brokerage at 2% on sale price. He invested Rs.80 lakhs in April, 2018 in equity shares of Shakti Manufacturing Private Limited, an eligible start-up company. Mr. Shakti subscribed to 80% of share capital of the company.

The company utilized the sum of Rs.80 lakhs in the following manner:

(i) Purchase of new machinery during April, 2018 Rs.70 lakhs (including Rs.10 lakhs for purchase of computers).

(ii) Deposit in specified bank on 25th September, 2018 Rs.10 lakhs.

The due date for filing return of income for Mr. Shakti for Assessment Year 2018-19 is 30th September, 2018. Assume that he files the return on 28th September, 2018.

Compute the taxable capital gain arising from the above transaction for Assessment Year 2018-19. (Cost Inflation Index: FY 2001-02: 100; FY 2017-18: 272)

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Answer

Computation of taxable capital gains of Mr. Shakti for A.Y. 2018-19

Particulars	`
Gross sale consideration	1,00,00,000
Less: Expenses on transfer (2% of the gross sale consideration)	2,00,000
Net sale consideration	**98,00,000**
Less: Indexed cost of acquisition (` 22,00,000 × 272/100)	59,84,000
Long term capital gains	38,16,000
Less: Exemption under section 54GB **(See Note below)** (` 38,16,000 × ` 80,00,000 / ` 98,00,000)	31,15,102
Taxable capital gains	**7,00,898**

Deemed cost of new plant and machinery for exemption under section 54GB

	Particulars	`
(1)	Purchase cost of new plant and machinery acquired in April, 2018	70,00,000
(2)	Amount deposited in the specified bank before the due date of filing of return	10,00,000
Deemed cost of new plant and machinery for exemption u/s 54GB		**80,00,000**

Note: Exemption under section 54GB can be availed on long-term capital gains on transfer of a residential house, since all the conditions given below are fulfilled by Mr. Shakti:

(i) The sale proceeds are used for subscription in the equity shares of an eligible start-up company.

(ii) Mr. Shakti holds more than 50% of the share capital in the said company.

(iii) Further, the amount of subscription as share capital has been utilized by the eligible company for purchase of new plant and machinery within a period of one year from the date of subscription.

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Question 11

X. Limited has transferred its Unit N to Y. Limited by way of slump sale on November 30, 2017. The summarised Balance Sheet of X. Limited as on that date is given below:

Liabilities	` (in lakhs)	Assets	` (in lakhs)
Paid up capital	*1,700*	*Fixed Assets :*	
Reserve & surplus	*620*	*Unit L*	*150*
Liabilities:		*Unit M*	*150*
Unit L	*40*	*Unit N*	*550*
Unit M	*110*	*Other Assets:*	
Unit N	*90*	*Unit L*	*520*
		Unit M	*800*
		Unit N	*390*
Total	***2,560***	***Total***	***2,560***

Using the further information given below, compute the capital gain arising from slump sale of Unit N and tax on such capital gain.

(i) Lump sum consideration on transfer of Unit N is Rs.880 lakhs.

(ii) Fixed assets of Unit N includes land which was purchased at Rs.60 lakhs in August 2006 and revalued at Rs.90 lakhs as on March 31, 2017.

(iii) Other fixed assets are reflected at Rs.460 lakhs (i.e. Rs.550 lakhs less value of land) which represents written down value of those assets as per books. The written down value of these assets under section 43(6) of the Income-tax Act, 1961 is Rs.410 lakhs.

(iv) Unit N was set up by X. Limited in July, 2006.

(v) Cost inflation index for financial year 2006-07 and financial year 2017-18 are 122 and 272, respectively.

Answer

Computation of capital gain on slump sale of Unit N under section 50B

Particulars	` (in lacs)
Sale consideration for the slump sale of Unit N	880
Less: Net worth of Unit N (Refer Note 1 below)	770
Long term capital gain arising on slump sale	**110**

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Computation of tax liability of X Ltd. on slump sale of Unit N

Particulars	` (in lacs)
Tax on capital gains@20%	22.00
Add: Surcharge@7%	1.54
	23.54
Add: Education cess@2% and Secondary and higher education cess@1%	0.71
Total tax liability on capital gain arising on slump sale of Unit N	**24.25**

Notes:

1. The net worth of an undertaking transferred by way of slump sale shall be deemed to the cost of acquisition and cost of improvement for the purposes of section 48 and 49 [Section 50B(2)].

Computation of net worth of Unit N

Particulars	` (in lacs)
(A) Book value of non-depreciable assets:	
(i) Land (Revaluation is to be ignored for computing net worth)	60
(ii) Other assets	390
(B) Written down value of depreciable assets under section 43(6)	410
Aggregate value of total assets	860
Less: Value of liabilities of Unit N	90
Net worth of Unit N	**770**

2. Since Unit N is held for more than 36 months, the capital gains of Rs.110 lacs arising on transfer of such unit would be a long term capital gain taxable under section 112. However, indexation benefit is not available in the case of a slump sale.

Question 12

Following are the details of income provided by Mr. Singh, the assessee for the financial year ended 31st March, 2018:

(i) Rental income from property at Bangalore - Rs.3 lakhs, Standard Rent - Rs.2,50,000, Fair Rent - Rs.2,80,000.

(ii) Municipal and water tax paid during 2017-18: Current year Rs.35,000, Arrears - Rs.1,50,000.

(iii) Interest on loan borrowed towards major repairs to the property: Rs.1,50,000.

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(iv) Arrears of rent of Rs.30,000 received during the year, which was not charged to tax in earlier years.

Further, the assessee furnished following additional information regarding sale of property at Chennai :

(i) Mr. Singh's father acquired a residential house in April 2005 for Rs.1,25,000 and thereafter gifted this property to the assessee, Mr. Singh on 1st March, 2006.

(ii) The property, so gifted, was sold by Mr. Singh on 10th June 2017. The consideration received was Rs.25,00,000.

(iii) Stamp duty charges paid by the purchaser at the time of registration @ 13% (as per statutory guidelines) was Rs.3,90,000.

(iv) Out of the sale consideration received:

(a) On 2/1/2018, the assessee had purchased two adjacent flats, in the same building, and made suitable modification to make it as one unit. The investment was made by separate sale deeds, amount being Rs.8,00,000 and Rs.7,00,000, respectively.

(b) On 10/l0/2017, Rs.10 lakhs was invested in bonds issued by National Highways Authority of India, but the allotment of the bonds was made on 1.2.2018.

Compute Mr. Singh's taxable income for assessment year 2018-19.

Cost inflation index: F.Y. 2005-06: 117; F.Y. 2017-18: 272

Answer

Computation of taxable income of Mr. Singh for A.Y.2018-19

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Particulars		`	`
Income from house property			
Gross Annual Value [Higher of Expected Rent & Actual Rent]			3,00,000
Expected Rent (lower of Fair Rent and Standard Rent)		2,50,000	
Actual Rent		3,00,000	
Less: Municipal taxes paid by Mr. Singh during the year (including arrears) [` 35,000 + `1,50,000]			1,85,000
Net Annual Value (NAV)			1,15,000
Less: Deductions under section 24			
(a) 30% of NAV		34,500	
(b) Interest on loan borrowed for major repairs		1,50,000	1,84,500
			(69,500)
Arrears of rent taxable under section 25A		30,000	
Less: Deduction@30%		9,000	21,000
			(48,500)
Capital Gains			
Full value of consideration		30,00,000	
As per section 50C, the full value of consideration would be the higher of -			
Actual Consideration	` 25,00,000		
Stamp Duty Value [` 3,90,000/13%]	` 30,00,000		

Less: **Indexed cost of acquisition** [Rs.1,25,000 × 272/117]		
As per section 49(1), cost of acquisition of the residential house gifted by Mr. Singh's father to Mr. Singh would be the cost for which Mr. Singh's father acquired the asset	2,90,598	
	27,09,402	
Less: **Exemption under section 54 (Rs.8,00,000 + Rs.7,00,000)**	15,00,000	

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Purchase of residential house within the stipulated time (within one year before or two years after the date of sale) [Where the flats are situated side by side and the builder had effected the necessary modification to make it as one house, the assessee would be entitled to exemption under section 54 in respect of investment in both the flats, despite the fact that they were purchased by separate sale deeds] [CIT v. Ananda Basappa (2009) 331 ITR 211 (Kar.)]		
Exemption under section 54EC	10,00,000	
Investment in bonds of NHAI within six months from the date of transfer. Where the payment for bonds has been made within the six month period, exemption under section 54EC would be available even if the allotment of bonds was made after the expiry of the six months [Hindustan Unilever Ltd. v. DCIT (2010) 325 ITR 102 (Bom.)] **Long-term capital gains**		2,09,402
Total Income		**1,60,902**

Question 13

SS(P) Ltd., a domestic Indian company having two undertakings engaged in manufacture of cement and steel, decided to hive off cement division to RV(P) Ltd., a domestic Indian company, by way of demerger. The net worth of SS(P) Ltd. immediately before demerger was Rs.40 crores. The net book value of assets transferred to RV(P) Ltd. was Rs.10 crores. The demerger was made in January 2018. In the scheme of demerger, it was fixed that for each equity share of Rs.10 each (fully paid up) of SS(P) Ltd., two equity shares of Rs.10 each (fully paid up) were to be issued.

One Mr. N.K. held 25,000 equity shares in SS(P) Ltd. which were acquired in the financial year 2003-04 for Rs.6,00,000. Mr. N.K. received 50,000 equity shares from RV(P) Ltd. consequent to demerger in January 2018. He sold all the shares of RV(P) Ltd. for Rs.8,00,000 in March, 2018. In this background you are requested to answer the following:

Does the transaction of demerger attract any income tax liability in the hands of SS(P) Ltd. and RV(P) Ltd.?

(i) Compute the capital gain that could arise in the hands of Mr. N.K. on receipt of shares of RV(P) Ltd.

(ii) Compute the capital gain that could arise in the hands of Mr. N.K. on sale of shares of RV(P) Ltd.

(iii) Will the sale of shares by Mr. N.K. affect the tax benefits availed by SS(P) Ltd. and/or RV(P) Ltd.?

(iv) Is Mr. N.K. eligible to avail any tax exemption under any of the provisions of the Income-tax Act, 1961 on the sale of shares of RV(P) Ltd.? If so, mention in brief.

Note:	**Financial Year**	**Cost inflation index**
	2003-04	109
	2017-18	272

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Answer

(i) No, the transaction of demerger would not attract any income-tax liability in the hands of SS(P) or RV(P) Ltd.

As per section 47(vib), any transfer in a demerger, of a capital asset, by the demerged company to the resulting company would not be regarded as "transfer" for levy of capital gains tax if the resulting company is an Indian company.

Hence, capital gains tax liability would not be attracted in the hands of SS(P) Ltd., the demerged company, in this case, since RV(P) Ltd. is an Indian company

(ii) There would be no capital gains liability in the hands of Mr. N.K. on receipt of shares of RV (P) Ltd., since as per section 47(vid), any issue of shares by the resulting company in a scheme of demerger to the shareholders of the demerged company will not be regarded as "transfer" for levy of capital gains tax, if the issue is made in consideration of demerger of the undertaking.

(iii) Yes, capital gains would arise in the hands of Mr. N.K. on sale of shares of RV (P) Ltd.

Sale consideration	8,00,000

Less: Indexed cost of acquisition of shares of RV (P) Ltd.

Cost of acquisition of shares of RV(P) Ltd. as per section 49(2C):

$$\text{Cost of acquisition of shares of SS(P) Ltd.} \times \frac{\text{Net book value of assets transferred in a demerger}}{\text{Net worth of the demerged company immediately before demerger}}$$

$$₹6,00,000 \times \frac{10 \text{ crore}}{40 \text{ crore}} = ₹1,50,000$$

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Indexed cost of acquisition of shares of RV (P) Ltd. [Rs.1,50,000 × 272/109]

Rs.3,74,31

2 Long-term capital gain (since period of holding of shares in demerged company is also to be considered) **Rs.4,25,688**

(iv) No, sale of shares by Mr. N.K. would not affect the tax benefits availed by SS(P) Ltd. or RV (P) Ltd.

One of the conditions to be satisfied is that the shareholders holding not less than three-fourths in value of the shares in the demerged company become shareholders of the resulting company by virtue of the demerger. It is presumed that the condition is satisfied in this case.

There is no stipulation that they continue to remain shareholders for any period of time thereafter.

(v) Since the resultant capital gain on sale of shares of RV(P) Ltd. is a long-term capital gain (on account of the period of holding of shares in demerged company being considered by virtue of section 2(42A)(g)), Mr. N.K. can avail exemption –

(1) under section 54EC by investing the long-term capital gains in bonds of National Highways Authority of India (NHAI) or Rural Electrification Corporation Ltd. (RECL) or notified bonds within a period of 6 months from the date of transfer; or

(2) under section 54EE, by investing the long-term capital gain units of specified fund, within a period of 6 months from the date of transfer.

(3) under section 54F by investing the entire net consideration in purchase (within one year before and two years after the date of transfer) or construction (within three years after the date of transfer) of one residential house in India. If part of the net consideration is invested, only proportionate exemption would be available.

Question 14

The Balance sheet of JB Opticals Limited as on 31-03-2018 reads as under:

Paid up capital Rs.2,52,00,000

	Unit A (Rs.)	Unit B (Rs.)
Fixed assets	1,00,00,000	1,50,00,000
Debtors	1,00,00,000	75,00,000
Liabilities	28,00,000	50,00,000
Stock in trade	50,00,000	25,00,000
Reserves		1,48,00,000
Share premium		22,00,000

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The company acquired Unit B on 1.04.2015. They made certain capital additions in the form of Generator set and additional building etc., for Rs.25 lacs during the year 2015-16. The members of the company have authorized the Board in their meeting held on 28.01.2018 to dispose of Unit 'B'. The company decides to sell Unit 'B' by way of slump sale for Rs.225 lacs as consideration. JB Opticals Ltd. has offered 1% discount if the buyer closes the sale and makes payment before 31.03.2018. However, this discount would not be available if the sale is completed (and payment is made) after 31.03.2018. You are required to advise the company as a measure of tax planning to determine the date of sale keeping in view the capital gains tax. Assume that the written down value of the fixed assets as per section 43(6) is Rs.120 lacs.

Solution

Determination of net worth of Unit B of M/s. J.B. Opticals Ltd.

	` (in lacs)
Written down value of fixed assets	120
Debtors	75
Stock-in-trade	25
	220
Less : Liabilities	50
Net worth	**170**

Comparative calculation of chargeable capital gains

	Sale before 31.3.2018	Sale after 31.03.2018
Sale consideration	2,25,00,000	2,25,00,000
Less: Discount	2,25,000	Nil
Net sale consideration	2,22,75,000	2,25,00,000
Less: Net worth	1,70,00,000	1,70,00,000
Short term capital gain	52,75,000	N.A.
Long term capital gain	N.A.	55,00,000
Tax rate	30.9%	20.6%
Tax thereon	**16,29,975**	**11,33,000**

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Computation of Net Cash flow

	Sale before 31.3.2018	Sale after 31.03.2018
Net sale consideration	2,22,75,000	2,25,00,000
Less: Income-tax	16,29,975	11,33,000
Net Cash flow	**2,06,45,025**	**2,13,67,000**

Note: The assessee is advised to effect slump sale after 31.03.2018 as the tax liability arising out of long term capital gains is less than the tax liability arising on short term capital gains and the net cash flow is also higher, if Unit B is transferred after 31.03.2018.

Question 15

PQR Limited has two units - one engaged in manufacture of computer hardware and the other involved in developing software. As a restructuring drive, the company has decided to sell its software unit as a going concern by way of slump sale for Rs.385 lacs to a new company called S Limited, in which it holds 74% equity shares.

The balance sheet of PQR limited as on 31st March 2018, being the date on which software unit has been transferred, is given hereunder –

Balance Sheet as on 31.3.2018

Liabilities	` *(in lacs)*	*Assets*	` *(in lacs)*
Paid up Share Capital	*300*	*Fixed Assets*	
General Reserve	*150*	*Hardware unit*	*170*
Share Premium	*50*	*Software unit*	*200*
Revaluation Reserve	*120*	*Debtors*	
Current Liabilities		*Hardware unit*	*140*
Hardware unit	*40*	*Software unit*	*110*
Software unit	*90*	*Inventories*	
		Hardware unit	*95*
		Software unit	*35*
	750		***750***

Following additional information are furnished by the management:

(i) The Software unit is in existence since May, 2014.

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(ii) Fixed assets of software unit includes land which was purchased at Rs.40 lacs in the year 2007 and revalued at Rs.60 lacs as on March 31, 2018.

(iii) Fixed assets of software unit mirrored at Rs.140 lacs (Rs.200 lacs minus land value Rs.60 lacs) is written down value of depreciable assets as per books of account. However, the written down value of these assets under section 43(6) of the Income-tax Act, 1961 is Rs.90 lacs.

(a) Ascertain the tax liability, which would arise from slump sale to PQR Limited.

(b) What would be your advice as a tax-consultant to make the restructuring plan of the company more tax-savvy, without changing the amount of sale consideration?

Answer

(a) As per section 50B, any profits and 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 capital assets and shall be deemed to be the income of the previous year in which the transfer took place.

If the assessee owned and held the undertaking transferred under slump sale for more than 36 months before slump sale, the capital gain shall be deemed to be long-term capital gain. Indexation benefit is not available in case of slump sale as per section 50B(2).

Ascertainment of tax liability of PQR Limited from slump sale of software unit

Particulars	` (in lacs)
Sale consideration for slump sale of Software Unit	385
Less: Cost of acquisition being the net worth of Software Unit	185
Long term capital gains arising on slump sale	**200**
(The capital gains is long-term as the Software Unit is held for more than 36 months)	
Tax liability on LTCG	
Under section 112 @ 20% on ` 200 lacs	40.00
Add: Surcharge@ 7%	2.80
	42.80
Add: Education cess@2% and SHEC@1%	1.28
	44.08

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Working Note:

Computation of net worth of Software Unit

	` (in lacs)
(1) Book value of non-depreciable assets	
(i) Land (Revaluation not to be considered)	40
(ii) Debtors	110
(iii) Inventories	35
(2) Written down value of depreciable assets under section 43(6) ***(See Note below)***	90
Aggregate value of total assets	275
Less: Current liabilities of software unit	90
Net worth of software unit	**185**

Note : For computing net worth, the aggregate value of total assets in the case of depreciable assets shall be the written down value of the block of assets as per section 43(6).

(b) Tax advice

(i) Transfer of any capital asset by a holding company to its 100% Indian subsidiary company is exempt from capital gains under section 47(iv). Hence, PQR Limited should try to acquire the remaining 26% equity shares in S Limited then make the slump sale in the above said manner, in which case the slump sale shall be exempt from tax. For this exemption, PQR Limited will have to keep such 100% holding in S Limited for a period of 8 years from the date of slump sale, otherwise the amount exempt would be deemed to be income chargeable under the head "Capital Gains" of the previous year in which such transfer took place.

(ii) Alternatively, if acquisition of 26% share is not feasible, PQR Limited may think about demerger plan of Software Unit to get benefit of section 47(vib) of the Income-tax Act, 1961.

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SIGNIFICANT SELECT CASES

1. Whether indexation benefit in respect of the 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?

CIT v. Manjula J. Shah (2013) 355 ITR 474 (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 meant 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.

Facts of the case: 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.

High Court's Observations: In the present case, the Bombay High Court observed 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.

High Court's Decision: Hence, 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.

Note - *The Delhi High Court, in the case of* ***Arun Shungloo Trust v. CIT (2012) 205 Taxman 456 (Delhi)*** *has also given the similar view on the said issue. The Court observed that as per Explanation (iii) to section 48, the expression 'asset held by the assessee' is not defined and*

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therefore, in the absence of any intention to the contrary, it has to be construed in consonance with the meaning given in section 2(42A). However, the Assessing Officer contended that in cases covered under section 49, the benefit of indexed cost of acquisition will be available only from the date the capital asset was transferred and not from the date on which the asset was held by the previous owner.

The High Court observed that this will result in inconsistency because as per the provisions of Explanation to section 48, the holding of predecessor has to be accounted for the purpose of computing the cost of acquisition, the cost of improvement and indexed cost of improvement, but not for the purpose of indexed cost of acquisition.

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 in which the asset was first held by the previous owner and accordingly the cost inflation index for the year the asset was first held by the previous owner would be considered for determining the indexed cost of acquisition.

2. Where a building, comprising of several floors, has been developed and re-constructed, would exemption under section 54/54F be available in respect of the cost of construction of -

(i) the new residential house (i.e., all independent floors handed over to the assessee); or

(ii) a single residential unit (i.e., only one independent floor)?

CIT v. Gita Duggal (2013) 357 ITR 153 (Delhi)

Facts of the case: In the present case, the assessee was the owner of property comprising the basement, ground floor, first floor and second floor. In the year 2006, she entered into a collaboration agreement with a builder for developing the property. According to the terms of the agreement, the builder was to demolish the existing structure on the plot of land and develop, construct, and/or put up a building consisting of basement, ground floor, first floor, second floor and third floor with terrace at its own costs and expenses. The assessee handed over to the builder, the physical possession of the entire property, along with 22.5% undivided interest over the land. The handing over of the entire property was, however, only for the limited purpose of development. The builder was to get the third floor plus the undivided interest in the land to the extent of 22.5% for his exclusive enjoyment. In addition to the cost of construction incurred by the builder on development of the property, a further amount of Rs.4 crores was payable by the builder to the assessee as consideration against the rights of the assessee.

Assessee's contention vis-à-vis Assessing Officer's contention: The assessee, in her return of income, showed only Rs.4 crores as sales consideration. The Assessing Officer, however, took the view that the sale consideration for the transfer should include not only the

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amount of Rs.4 crores received by the assessee in cash, but also the cost of construction amounting to Rs.3.44 crore incurred by the developer in respect of the other floors, which were handed over to the assessee.

The assessee contended that if the cost of construction incurred by the builder is to be added to the sale price, then, the same should also correspondingly be considered as re-investment in the residential house for exemption under section 54.

However, the Assessing Officer rejected the claim for exemption under section 54 on the ground that the floors obtained by the assessee contained separate residential units having separate entrances and cannot qualify as a single residential unit. He contended that deduction under section 54F was allowable, and that too only in respect of cost of construction incurred in respect of one unit i.e., one floor.

Appellate Authorities' views: The Commissioner (Appeals), on the basis of the judgment in CIT v. D. Ananda Basappa [2009] 309 ITR 0329 (Kar.), took a contrary view. The Tribunal concurred with the view of the Commissioner (Appeals).

High Court's Observations: The High Court observed that sections 54 and 54F use the expression "residential house" and not "residential unit" and it is the Assessing Officer who has introduced a new concept of "residential unit" into these sections. Sections 54 and 54F require the assessee to acquire a "residential house" and so long as the assessee acquires a building, which may be constructed, for the sake of convenience, in such a manner as to consist of several units which can, if the need arises, be conveniently and independently used as an independent residence, the requirement of the section should be taken to have been satisfied. There is nothing in these sections which requires the residential house to be constructed in a particular manner. The only requirement is that it should be for residential use and not for commercial use. The physical structuring of the new building, whether lateral or vertical, should not come in the way of considering the building as a residential house.

High Court's Decision: The High Court held that the fact that the residential house consists of several independent units cannot be permitted to act as an impediment to the allowance of the deduction under section 54 or section 54F. It is neither expressly nor by necessary implication prohibited. Therefore, the assessee is entitled to exemption of capital gains in respect of investment in the residential house, comprising of independent residential units handed over to the assessee.

Note – The Department's Special Leave Petition against the Delhi High Court's judgment was dismissed on 29th August, 2014.

3. Would an assessee be entitled to exemption under section 54 in respect of purchase of two flats, adjacent to each other and having a common meeting point?

CIT v. Syed Ali Adil (2013) 352 ITR 0418 (A.P.)

Facts of the case: The assessee-individual had inherited an ancestral house property, which he sold during the relevant previous year. Out of the sale consideration, he purchased two adjacent residential flats. The assessee claimed exemption under section 54 in respect of investment in both the residential flats, in view of the decision of the Karnataka High Court in

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CIT v. Ananda Basappa (2009) 309 ITR 329, wherein investment in two adjacent flats were considered eligible for exemption under section 54.

Assessing Officer's contention: The Assessing Officer, however, restricted the exemption under section 54 only in respect of investment in one residential flat (including stamp duty paid for registration of the flat), contending that –

(i) the two residential units were separated by a strong wall;

(ii) the two flats were purchased from two different vendors under two separate sale deeds.

Appellate Authorities' views: The Commissioner (Appeals), however, observed that the assessee was entitled to exemption under section 54 in respect of investment in both the flats, since the two flats had adjacent kitchens and toilets and also had a common meeting point. The Tribunal concurred with the view of the Commissioner (Appeals).

High Court's Observations: On appeal by the Revenue, the High Court referred to the Karnataka High Court decision in CIT v. Ananda Basappa (2009) 309 ITR 329, wherein it was observed that where the flats are situated side by side and the builder had effected the necessary modification to make it as one unit, the assessee would be entitled to exemption under section 54 in respect of investment in both the flats, despite the fact that they were purchased by separate sale deeds.

The above ruling was also followed by the Karnataka High Court in CIT v. K.G. Rukminiamma (2011) 331 ITR 211, wherein it was held that where a residential house was transferred and four flats in a single residential complex were purchased by the assessee, all the four residential flats constituted "a residential house" for the purpose of section 54.

High Court's Decision: The Andhra Pradesh High Court, on the basis of the above rulings of the Karnataka High Court, held that in this case, the assessee was entitled to investment in both the flats purchased by him, since they were adjacent to each other and had a common meeting point, thus, making it a single residential unit.

Note – Sections 54 and 54F have been amended by the Finance (No.2) Act, 2014 to clarify that the exemption available thereunder would be in respect of investment in one residential house in India. In this case as well as in Ananda Basappa's case, the assessee had invested in two adjacent flats and necessary modification was effected so that the flats can be used as a single residence. The respective High Courts had held that the assessees were entitled to exemption under section 54 in respect of investment in both the residential flats, since they were intended to be used as a single residence and necessary modification had also been effected so that the two flats located side by side can be used as a single residence. It appears that even after the amendment by the Finance (No.2) Act, 2014, the above rulings will continue to hold good, since the restriction is regarding investment being made in one residential house, and not in one unit of a residential house.

4. Can exemption under section 54B be denied solely on the ground that the new agricultural land purchased is not wholly owned by the assessee, as the assessee's son is a co-owner as per the sale deed?

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CIT v. Gurnam Singh (2010) 327 ITR 278 (P&H)

Facts of the case: The assessee claimed deduction under section 54B in respect of the land purchased by him along with his son out of the sale proceeds of the agricultural land. However, the same was denied by the Assessing Officer on the ground that the land was registered in the name of the assessee's son.

Tribunal's Observation: The Tribunal observed that the agricultural land sold belonged to the assessee and the sale proceeds were also used for purchasing agricultural land. The possession of the said land was also taken by the assessee. It is not the case that the sale proceeds were used for other purposes or beyond the stipulated period. The only objection raised by the Revenue was that the land was registered in the name of his son. Therefore, it cannot be said that the capital gains were in any way misused for any other purpose contrary to the provisions of law.

High Court's Decision: In this case, the High Court concurred with the Tribunal's view that merely because the assessee's son was shown in the sale deed as co-owner, it did not make any difference. It was not the case of the Revenue that the land in question was exclusively used by the son. Therefore, the assessee was entitled to deduction under section 54B.

5. Can exemption under section 54F be denied solely on the ground that the new residential house is purchased by the assessee exclusively in the name of his wife?

CIT v. Kamal Wahal (2013) 351 ITR 4 (Delhi)

Facts of the case: The assessee sold a capital asset and invested the sale proceeds in purchase of a new house in the name of his wife. He claimed deduction under section 54F in respect of the new residential house purchased by him in the name of his wife. However, the same was denied by the Assessing Officer on the ground that, in order to avail the benefit under section 54F, the investment in the residential house should be made by the assessee in his own name.

The Tribunal, however, accepted the assessee's contention observing that since section 54F is a beneficial provision enacted for encouraging investment in residential houses, the said provision has to be interpreted liberally.

High Court's Observations: The Delhi High Court concurred with the Tribunal's view and observed that, for the purpose of section 54F, a new residential house need not necessarily be purchased by the assessee in his own name nor is it necessary that it should be purchased exclusively in his name. A similar view was upheld by this Court in CIT v. Ravinder Kumar Arora (2012) 342 ITR 38, where the new residential house was acquired in the joint names of the assessee and his wife and the Court had held that the assessee was entitled for 100% exemption under section 54F. In that case, it was further observed that section 54F does not require purchase of new residential house property in the name of the assessee himself. It only requires the assessee to purchase or construct a residential house.

Further, in this case, the Delhi High Court observed that the assessee had not purchased the new house in the name of a stranger or somebody who is unconnected with him, but had purchased it in the name of his wife. The entire investment for purchase of new residential

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house had come out of the sale proceeds of the capital asset (of the assessee) and there was no contribution from his wife.

High Court's Decision: Hence, the Delhi High Court, having regard to the rule of purposive construction and the object of enactment of section 54F, held that the assessee is entitled to claim exemption under section 54F in respect of utilization of sale proceeds of capital asset for investment in residential house property in the name of his wife.

6. In case of a house property registered in joint names, whether the exemption under section 54F can be allowed fully to the co-owner who has paid whole of the purchase consideration of the house property or will it be restricted to his share in the house property?

CIT v. Ravinder Kumar Arora (2012) 342 ITR 38 (Delhi)

Facts of the case: In the present case, the assessee filed the return of income showing long-term capital gain on sale of plot of land. The assessee claimed exemption under section 54F from such long-term capital gain on account of purchase of new residential house property within the stipulated time period as mentioned in the aforesaid section. He claimed exemption under section 54F taking into consideration the whole of purchase price of the residential house property. However, after going through the purchase deed of the house property, the Assessing Officer found that the said house property was purchased in joint names of assessee and his wife. Therefore, the Assessing Officer allowed 50% of the exemption claimed under section 54F, being the share of the assessee in the property purchased in joint names.

The assessee submitted that the inclusion of his wife's name in the sale deed was just to avoid any litigation after his death. He further explained that all the funds invested in the said house were provided by him, including the stamp duty and corporation tax paid at the time of the registration of the sale deed of the said house. This fact was also clearly evident from the bank statement of the assessee. The assessee claimed that the exemption under section 54F is to be allowed with reference to the full amount of purchase consideration paid by him for the aforesaid residential house and is not to be restricted to 50%. The Assessing Officer did not deny the fact that the whole amount of purchases of the house was contributed by the assessee and nothing was contributed by his wife. However, the Assessing Officer opined that exemption under section 54F shall be allowed only to the extent of assessee's right in the new residential house property purchased jointly with his wife, i.e. 50%.

High Court's Decision: Considering the above mentioned facts, the Delhi High Court held that the assessee was the real owner of the residential house in question and mere inclusion of his wife's name in the sale deed would not make any difference. The High Court also observed that section 54F mandates that the house should be purchased by the assessee but it does not stipulate that the house should be purchased only in the name of the assessee. In this case, the house was purchased by the assessee in his name and his wife's name was also included additionally. Therefore, the conditions stipulated in section 54F stand fulfilled and the entire

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exemption claimed in respect of the purchase price of the house property shall be allowed to the assessee.

Note - *A similar view was taken by the Karnataka High Court in the case of* ***DIT (IT) v. Mrs. Jennifer Bhide (2011) 203 Taxman 208,*** *in the context of deductions under section 54 and 54EC, wherein the assessee had sold a residential house property. The assessee, in order to claim exemption of the long-term capital gain, made the investment in the residential house property and bonds jointly in her name and in the name of her husband. The Karnataka High Court, in this case, observed that it was clear from the facts of this case that the entire investment was done by the assessee and no contribution was made by her husband. Therefore, in the present case, it was, held that section 54 and 54EC only stipulate that the capital gain arising on a sale of property is to be invested in a residential house property or in the long-term specified asset i.e., bonds. It is not mandatory in those sections that the investment is to be made in the name of the assessee only. The name of the assessee's husband is shown in the sale deed as well as in the bonds, as a joint owner. However, since the consideration for acquisition flows entirely from the assessee's funds, the assessee is entitled to claim deduction under section 54 and 54EC in respect of the full amount invested. Therefore, in the present case, the exemption under section 54 and 54EC shall not be restricted to 50%, being the share of the assessee in the ownership of the house property and the bonds. The assessee is entitled to 100% exemption of the long-term capital gain so invested in the residential house property and in the bonds.*

7. Can exemption under section 54F be denied to an assessee in respect of investment made in construction of a residential house, on the ground that the construction was not completed within three years after the date on which transfer took place, on account of pendency of certain finishing work like flooring, electrical fittings, fittings of door shutter, etc?

CIT v. Sambandam Udaykumar (2012) 345 ITR 389 (Kar.)

Facts of the case: In this case, the assessee has claimed benefit of exemption under section 54F in respect of capital gain arising on sale of shares of a company by investing the amount in construction of a house property. However, the Assessing Officer contended that no exemption under section 54F would be available in this case, as the construction of a residential house was not completed on account of pendency of certain work like flooring, electrical fittings, fittings of door shutter, etc., even after lapse of three years from the date of transfer of the shares.

High Court's Observations: The Karnataka High Court observed that the condition precedent for claiming the benefit under section 54F is that capital gains realized from sale of capital asset should have been invested either in purchasing a residential house or in constructing a residential house within the stipulated period. If he has invested the money in the construction of a residential house, merely because the construction was not completed in all respects and possession could not be taken within the stipulated period, would not disentitle the assessee from claiming exemption under section 54F. In fact, in this case, the assessee has taken the

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possession of the residential building and is living in the said premises despite the pendency of flooring work, electricity work, fitting of door and window shutters.

High Court's Decision: The Court held that in this case the assessee would be entitled to exemption under section 54F in respect of the amount invested in construction within the prescribed period.

8. In a case where a depreciable asset held for more than 36 months is transferred, can benefit of exemption under section 54EC be claimed, if the capital gains on sale of such asset are reinvested in long-term specified assets within the specified time?

CIT v. V.S. Dempo Company Ltd (2016) 387 ITR 354 (SC)

Facts of the case: The assessee sold its loading platform (a depreciable asset, held for 17 years) for Rs.137.25 lakhs and re-invested the resultant capital gain in long-term specified assets under section 54EC and claimed exemption thereunder. The Assessing Officer, however, rejected the claim for exemption under section 54EC on the ground that assessee had claimed depreciation on such asset and therefore, the provisions of section 50 were applicable. The Commissioner (Appeals) upheld the order of Assessing Officer.

The Appellate Tribunal, however, allowed the appeal of the assessee, holding that the asset, though a depreciable asset, was held for more than 36 months before its sale and, hence, the reinvestment of capital gains in long-term specified assets is eligible for exemption under section 54EC.

High Court's Observations: The High Court observed that section 50 is a special provision for computation of capital gains in the case of depreciable asset, and has limited application in the context of computation of capital gains to the extent that the provisions of sections 48 and 49 would apply with the modifications stated thereunder. It does not deal with exemption which is provided in a totally different provision i.e. section 54EC.

The High Court referred the decision of the Bombay High Court in the case of CIT v. ACE Builders (P) Ltd (2006) 281 ITR 210 (Bom), wherein it was analysed that the assessee cannot be denied exemption under section 54EC, because firstly, there is nothing in section 50 to suggest that the fiction created therein is not restricted to only sections 48 and 49. Secondly, fiction created by the legislature has to be confined for the purpose for which is created. Thirdly, section 54EC does not make any distinction between depreciable and non-depreciable asset for the purpose of re-investment of capital gains in long term specified assets for availing the exemption there under. Further, section 54EC specifically provides that when the capital gain arising on the transfer a long-term capital asset is invested or deposited in long-term specified assets, the assessee shall not be subject to capital gains to that extent. Therefore, the exemption under section 54EC cannot be denied to the assessee on account of the fiction created in section 50.

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Supreme Court's Decision: The Apex Court, concurred with the view of the High Court holding that since the depreciable asset is held for more than 36 months and the capital gains are re-invested in long-term specified assets within the specified period, exemption under section 54EC cannot be denied.

Note: *The case in respect of which decision is rendered pertained to the assessment year 1989-90, and the above decision was in relation to exemption contained in section 54E. The rationale of the above decision can also be applied in the current context in relation to the exemption allowable under section 54EC on re-investment of capital gains in long-term specified assets being bonds issued by NHAI/RECL within six months from the date of transfer.*

9. Where the stamp duty value under section 50C has been adopted as the full value of consideration, can the reinvestment made in acquiring a residential property, which is in excess of the actual net sale consideration, be considered for the purpose of computation of exemption under section 54F, irrespective of the source of funds for such reinvestment?

Gouli Mahadevappa v. ITO (2013) 356 ITR 90 (Kar.)

Facts of the case: In the present case, the assessee sold a plot of land for Rs.20 lakhs and reinvested the sale consideration of Rs.20 lakhs together with agricultural income of Rs.4 lakhs, in construction of a residential house. The assessee claimed capital gains exemption under section 54F, taking into consideration the entire investment of Rs.24 lakhs. The Assessing Officer, applying the provisions of section 50C, deemed the stamp duty value of Rs.36 lakhs as the full value of consideration since the consideration received or accruing as a result of transfer of capital asset (i.e. Rs.20 lakhs) was less than the value adopted by the stamp valuation authority (i.e., Rs.36 lakhs). The same was not disputed by the assessee before the Assessing Officer.

Assessing Officer's contention vis-a-vis Assessee's contention: The Assessing Officer allowed exemption under section 54F, taking into consideration investment in construction of residential house, to the extent of actual net consideration of Rs.20 lakhs. He did not consider the balance amount of Rs.4 lakhs, invested in the construction of residential house, out of agricultural income, for computation of exemption under section 54F, even though the sale consideration adopted for the purpose of computation of capital gains i.e., stamp duty value of Rs.36 lakhs, was more than the amount of Rs.24 lakhs invested in the new house.

The assessee contended that the entire investment of Rs.24 lakhs made in construction of the residential house should be considered for computation of exemption under section 54F, irrespective of the source of funds for such reinvestment. Further, the assessee also contended before the High Court that the registration value adopted under section 50C was excessive and disproportionate to the market value of the property.

High Court's Observations: On the issue of applicability of section 50C, the Karnataka High Court observed that section 50C(2) allows an opportunity to the assessee to contend, before the Assessing Officer, the correctness of the registration value fixed by the State Government. Had he done so, the assessing authority would have invoked the power of appointing a

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Valuation Officer for assessing the fair market value of the property. The High Court held that when the assessee had not disputed the registration value at that point of time, it is not permissible for the assessee to now contend, at this stage, that the registration value does not correspond to the market value. Hence, the value of Rs.36 lakhs adopted under section 50C has to be deemed as the full value of consideration.

High Court's Decision: On the issue of exemption under section 54F, the High Court held that when capital gain is assessed on notional basis as per the provisions of section 50C, and the higher value i.e., the stamp duty value of ` 36 lakhs under section 50C has been adopted as the full value of consideration, the entire amount of ` 24 lakhs reinvested in the residential house within the prescribed period should be considered for the purpose of exemption under section 54F, irrespective of the source of funds for such reinvestment.

10. Can exemption under section 54EC be denied on account of the bonds being issued after six months of the date of transfer even though the payment for the bonds was made by the assessee within the six month period?

Hindustan Unilever Ltd. v. DCIT (2010) 325 ITR 102 (Bom.)

High Court's Observations: In this case, the Bombay High Court observed that in order to avail the exemption under section 54EC, the capital gains have to be invested in a long-term specified asset within a period of six months from the date of transfer. Where the assessee has made the payment within the six month period, and the same is reflected in the bank account and a receipt has been issued as on that date, the exemption under section 54EC cannot be denied merely because the bond was issued after the expiry of the six month period or the date of allotment specified therein was after the expiry of the six month period.

High Court's Decision: For the purpose of the provisions of section 54EC, the date of investment by the assessee must be regarded as the date on which payment is made. The High Court, therefore, held that if such payment is within a period of six months from the date of transfer, the assessee would be eligible to claim exemption under section 54EC.

11. Can advance given for purchase of land, building, plant and machinery tantamount to utilization of capital gain for purchase and acquisition of new machinery or plant and building or land, for claim of exemption under section 54G?

Fibre Boards (P) Ltd v. CIT (2015) 376 ITR 596 (SC)

Facts of the case: The assessee-company had an industrial unit in Thane, which had been declared a notified urban area by notification dated September 22, 1967, issued under section 280Y(d) of the Income-tax Act, 1961 vide Notification dated 22.09.1967. The assessee, in order to shift its industrial undertaking from an urban area to a non-urban area, sold its land, building and plant and machinery situated at Thane and out of the capital gains so earned, paid advances of various amounts to different persons for purchase of land, plant and machinery, construction of factory and building in the year 1991-92. The assessee claimed exemption under section 54G of the Income-tax Act, 1961, on the capital gains earned from the sale proceeds of its erstwhile industrial undertaking situated in Thane in view of the advances so

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made, which was more than the capital gains earned by it. The Assessing Officer refused to grant exemption to the assessee under section 54G on the ground that the non-urban area had not been declared to be so by any general or special order of the Central Government and that giving advances did not amount to utilisation of capital gains for acquiring the assets.

Appellate Authorities' views: The CIT (Appeals) dismissed the case of the assessee while the Appellate Tribunal allowed the appeal by stating that even an agreement to purchase is good enough and that Explanation to section 54G is declaratory in nature and would be retrospectively applicable.

High Court's Decision: The High Court reversed the order of the Appellate Tribunal and denied the exemption on the reasoning that the notification declaring Thane to be an urban area stood repealed with the repeal of the section under which it was made. Further the expression "purchase" in the section 54G cannot be equated with the expression "towards purchase" and accordingly the advance for purchase of land, plant and machinery would not entitle the assessee to claim exemption under section 54G.

Supreme Court's Observations: The Apex Court observed that, on a conjoint reading of the Speech of the Finance Minister introducing the Finance Bill, 1987, and the Notes on Clauses and Memorandum explaining the provisions of the Finance Bill of 1987, it becomes clear that the idea of omitting section 280ZA of the Income-tax Act, 1961 and introducing section 54G on the same date was to do away with the tax credit certificates scheme together with the prior approval required by the Board and to substitute the repealed provision with the new scheme contained in section 54G. Once section 280ZA was omitted from the statute book, section 280Y(d) having no independent existence would for all practical purposes also cease to exist. Section 280Y(d) which was a definition section defining "urban area" for the purpose of section 280ZA alone was also omitted subsequently by the Finance Act, 1990. Apart from this, section 54G(1) by its Explanation introduces the very definition contained in section 280Y(d) in the same terms. It is obvious that both provisions are not expected to be applied simultaneously and it is clear that the Explanation to section 54G(1) repeals, by implication, section 280Y(d).

Unlike section 6 of the General Clauses Act, 1897 which saves certain rights, section 24 merely continues notifications, orders, schemes, rules, etc., that are made under a Central Act which is repealed and re-enacted with or without modification. The idea of section 24 of the 1897 Act is, as its marginal note shows, to continue uninterrupted subordinate legislation that may be made under a Central Act that is repealed and re-enacted with or without modification.

Section 54G gives a time limit of 3 years after the date of transfer of capital asset in the case of shifting of industrial undertaking from urban area to any area other than urban area. The expression used in section 54G(2) is that the amount "which is not utilized by him for all or any of the purposes aforesaid has to be deposited in the capital gain account scheme".

For the purpose of availing exemption, all that was required for the assessee is to "utilise" the amount of capital gain for purchase and acquisition of new machinery or plant and building or land. Since the entire amount of capital gain, in this case, was utilized by the assessee by way of advance for acquisition of land, building, plant and machinery, the assessee was entitled to avail exemption/deduction under section 54G.

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Supreme Court's Decision: To avail exemption under section 54G in respect of capital gain arising from transfer of capital assets in the case of shifting of industrial undertaking from urban area to non-urban area, the requirement is satisfied if the capital gain is given as advance for acquisition of capital assets such as land, building and / or plant and machinery.

Note – In this case, two issues have been touched upon, namely, whether notification of an area as an urban area under a repealed provision would hold good under the re-enacted provision and whether advance given for purchase of an eligible asset would tantamount to utilisation of capital gains for purchase of the said asset for availing exemption under section 54G. The former issue was decided taking support from section 24 of the General Clauses Act, 1897, which provides for uninterrupted subordinate legislation in case of repeal and re- enactment, with or without modification. The latter issue was also decided in favour of the assessee by holding that payment of advance for purchase of eligible asset would tantamount to utilisation of capital gains for purchase of the said asset.

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Illustration 1

A Ltd., a domestic company, declared dividend of Rs.170 lakh for the year F.Y.2016-17 and distributed the same on 10.7.2017. Mr. X, holding 10% shares in A Ltd., receives dividend of Rs.17 lakh in July, 2017. Mr. Y, holding 5% shares in A Ltd., receives dividend of Rs.8.50 lakh. Discuss the tax implications in the hands of A Ltd., Mr. X and Mr. Y, assuming that Mr. X and Mr. Y have not received dividend from any other domestic company during the year.

Solution

(i) The dividend of Rs. 170 lakh declared and distributed in the P.Y.2017-18 is subject to dividend distribution tax under section 115-O in the hands of A Ltd. First of all, the dividend received has to be grossed up by applying the rate of 15%. The gross dividend is Rs. 200 lakhs [Rs. 170 lakhs x 100/85]. Dividend distribution tax @17.304% is Rs. 34.068 lakhs.

(ii) In the hands of Mr. X, dividend received upto Rs. 10 lakh would be exempt under section 10(34). Rs. 7 lakh, being dividend received in excess of Rs. 10 lakh, would be taxable @10% as per section 115BBDA. Such dividend would not be exempt under section 10(34). Therefore,tax payable by Mr. X on dividend of Rs. 7 lakh under section 115BBDA would be Rs. 72,100 [i.e., 10% of Rs. 7 lakh + cess @3%].

(iii) In the hands of Mr. Y, the entire dividend of Rs. 8.50 lakh received would be exempt under section 10(34), since only dividend received in excess of Rs. 10 lakh would be taxable under section 115BBDA

Illustration 2

Dhaval is in business of manufacturing customized kitchen equipments. He is also the Managing Director and held nearly 65% of the paid-up share capital of Aarav (P) Ltd. A substantial part of the business of Dhaval is obtained through Aarav (P) Ltd. For this purpose, Aarav (P) Ltd. passed on the advance received from its customers to Dhaval to execute the job work entrusted to him.

The Assessing Officer held that the advance money received by Dhaval is in the nature of loan given by Aarav (P) Ltd. to him and accordingly is deemed dividend within the meaning of provisions of section 2(22)(e) of the Income-tax Act, 1961. The Assessing Officer, therefore made the addition by treating advance money as the deemed dividend income of Dhaval.

Examine whether the action of the Assessing Officer is tenable in law.

Solution

As per section 2(22)(e), in case a company, not being a company in which the public are substantially interested, makes payment of any sum by way of advance or loan to a shareholder holding not less than 10% of voting power/share capital of the company, then, the payment so made shall be deemed to be dividend in the hands of such shareholder to the extent to which the company possesses accumulated profits.

In the present case, Dhaval is holding 65% of the paid-up capital of Aarav (P) Ltd. Aarav (P) Ltd. has passed on advance received from its customers to Dhaval for execution of job work entrusted to Dhaval.

Since Aarav (P) Ltd. is not a company in which public are substantially interested, the applicability of

the provisions of section 2(22)(e) in respect of such transaction has to be examined. In CIT v. Rajkumar (2009) 318 ITR 462 (Del.), it was held that trade advance given to the shareholder which is in the nature of money transacted to give effect to a commercial transaction, would not be deemed to be dividend in the hands of the shareholder under section 2(22)(e). The Delhi High Court ruling in CIT v. Ambassador Travels (P) Ltd. (2009) 318 ITR 376 also supports the above view.

In the present case, the payment is made to Dhaval by Aarav (P) Ltd. for execution of work is in the course of commercial business transaction and therefore, it shall not be deemed as dividend in the hands of Dhaval under section 2(22)(e). Hence, the action of the Assessing Officer is not tenable in law.

Illustration 3

MNO Ltd. is a company in which the public are not substantially interested. K is a shareholder of the company holding 15% of the equity shares. The accumulated profits of the company as on 31.3.2017 amounted to Rs.10,00,000. The company lent Rs.1,00,000 to K by an account payee bank draft on 1.10.2017. The loan was not connected with the business of the company. K repaid the loan to the company by an account payee bank draft on 30.3.2018. Examine the effect of the borrowal and repayment of the loan by K on the computation of his total income for the assessment year 2018-19.

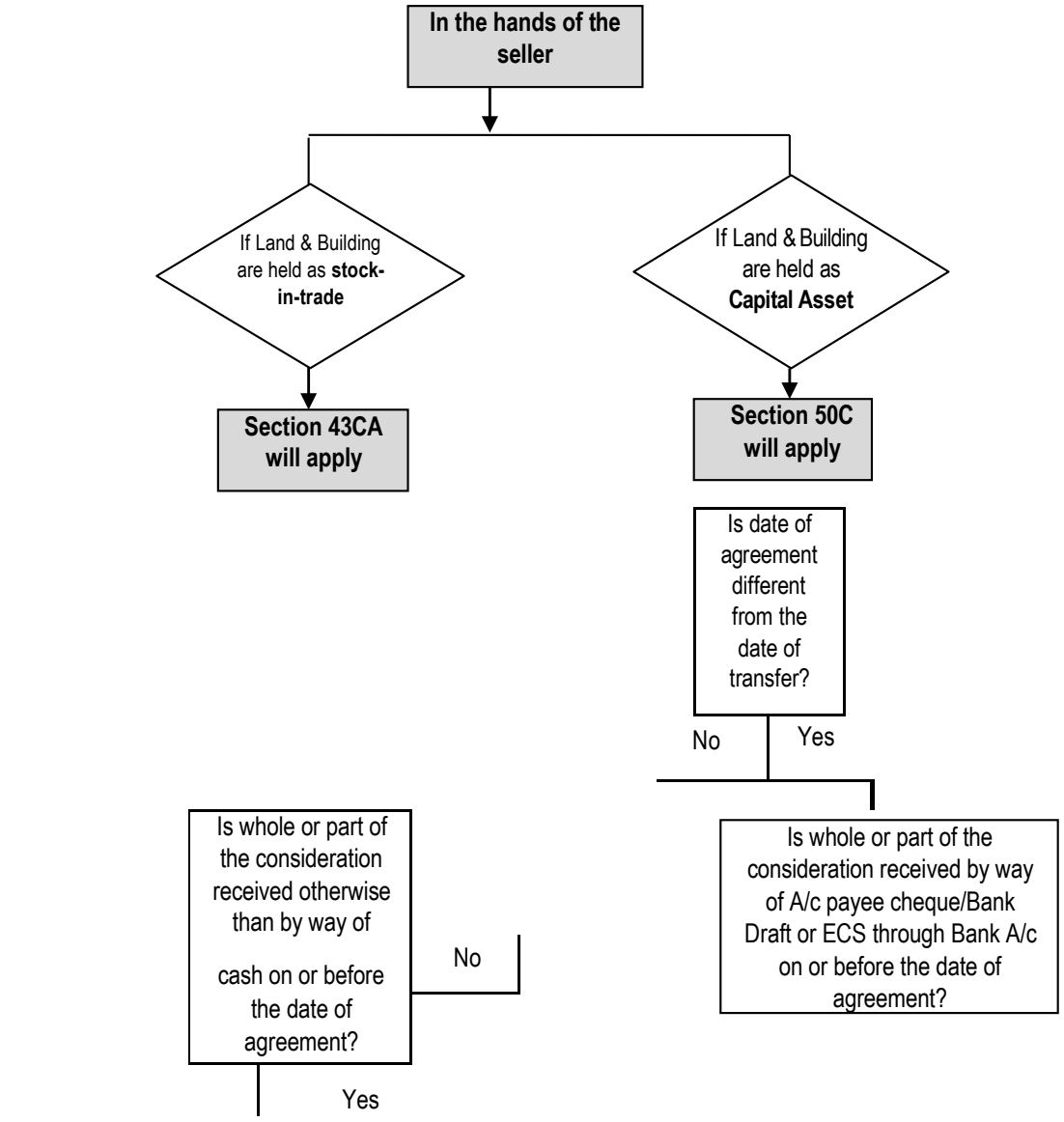
Solution

As per section 2(22)(e), any payment by a company, in which the public are not substantially interested, by way of advance or loan to a shareholder, being a person who is the beneficial owner of shares holding not less than 10% of the voting power, shall be treated as dividend to the extent to which the company possesses accumulated profits.

In the instant case, MNO Ltd. is a company in which the public are not substantially interested. The company has accumulated profits of Rs. 10,00,000 on 31.3.2017. The loan given by the company to K was not in the course of its business. K holds more than 10% of the equity shares in the company. Therefore, assuming that K has voting power equivalent to his shareholding, section 2(22)(e) comes into play and the sum of Rs. 1,00,000, representing the amount lent by the company to K, is includible as dividend in the total income of K for the assessment year 2018-19.

Under section 2(22)(e), the liability arises the moment the loan is borrowed by the shareholder and it is immaterial whether the loan is repaid before the end of the accounting year or not. Therefore, the repayment of loan by K to the company on 30.3.2018 will not affect the taxability of the sum of Rs. 1,00,000 as dividend in his hands.

Tax implications on transfer of immovable property for inadequate consideration



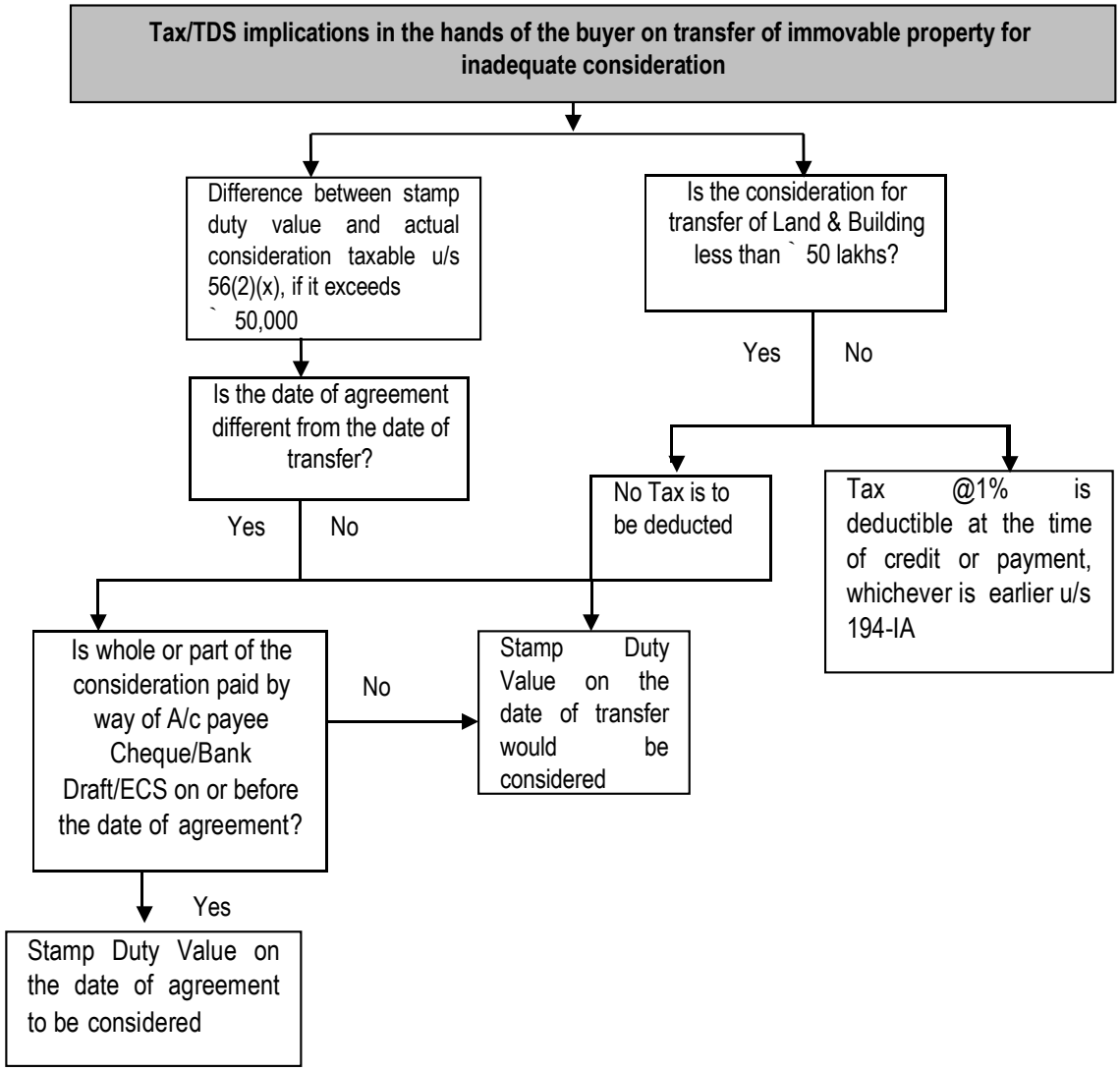


Illustration 4

Mr. A, a dealer in shares, received the following without consideration during the P.Y.2017-18 from his friend Mr. B, -

(1) Cash gift of Rs.75,000 on his anniversary, 15th April, 2017.

(2) Bullion, the fair market value of which was Rs.60,000, on his birthday, 19th June, 2017.

(3) A plot of land at Faridabad on 1st July, 2017, the stamp value of which is Rs.5 lakh on that date. Mr. B had purchased the land in April, 2008

Mr. A purchased from his friend Mr. C, who is also a dealer in shares, 1000 shares of X Ltd. @ Rs.400 each on 19th June, 2017, the fair market value of which was Rs.600 each on that date. Mr. A sold these shares in the course of his business on 23rd June, 2017.

Further, on 1st November, 2017, Mr. A took possession of property (building) booked by him two years back at Rs.20 lakh. The stamp duty value of the property as on 1st November, 2017 was Rs.32 lakh and on the date of booking was Rs.23 lakh. He had paid Rs.1 lakh by account payee cheque as down

payment on the date of booking.

On 1st March, 2018, he sold the plot of land at Faridabad for Rs.7 lakh.

Compute the income of Mr. A chargeable under the head "Income from other sources" and "Capital Gains" for A.Y.2018-19.

Solution

Computation of "Income from other sources" of Mr. A for the A.Y.2018-19

	Particulars	`
(1)	Cash gift is taxable under section 56(2)(x), 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)(x)	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)(x) as ` 1 lakh is paid on the date of booking by account payee cheque .	3,00,000
Income from Other Sources		**9,35,000**

Computation of "Capital Gains" of Mr. A for the A.Y.2018-19

Particulars	`
Sale Consideration	7,00,000
Less: Cost of acquisition [deemed to be the stamp value charged to tax under section 56(2)(x) 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 5

Discuss the taxability or otherwise of the following in the hands of the recipient under section 56(2)(x) the Income-tax Act, 1961 -

(i) Akhil HUF received Rs.75,000 in cash from niece of Akhil (i.e., daughter of Akhil's sister). Akhil is the Karta of the HUF.

(ii) 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 Rs.9,00,000.

(iii) 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 Rs.100 per share. He also received jewellery worth Rs.45,000 (FMV) from his nephew on the same day.

(iv) 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 Rs.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)(x). 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)(x). 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)(x), 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)(x), therefore, the same shall not be taxable.

Illustration 6

Mr. Hari, a property dealer, sold a building in the course of his business to his friend Mr. Rajesh, who is a dealer in automobile spare parts, for Rs.90 lakh on 1.1.2018, when the stamp duty value

was Rs.150 lakh. The agreement was, however, entered into on 1.9.2017 when the stamp duty value was Rs.140 lakh. Mr. Hari had received a down payment of Rs.15 lakh by a crossed cheque from Mr. Rajesh on the date of agreement. Discuss the tax implications in the hands of Mr. Hari and Mr. Rajesh, assuming that Mr. Hari has purchased the building for Rs.75 lakh on 12th July, 2016.

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)(x) would be attracted in the hands of Mr. Rajesh who has received immovable property, being a capital asset, for inadequate consideration. Therefore, ` **60 lakh,** being the difference between the stamp duty value of the property on the date of registration (i.e., ` 150 lakh) and the actual consideration (i.e., ` 90 lakh) would be taxable **under section 56(2)(x)** in the hands of Mr. Rajesh, since the payment is made by crossed cheque and not account payee cheque/draft or ECS.

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, the option to adopt the stamp duty value on the date of agreement can be exercised only if whole or part of the consideration has been received on or before the date of agreement by way of account payee cheque or draft or by use of ECS through a bank account on or before the date of agreement. In this case, since the payment is made by crossed cheque, the option cannot be exercised.	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)(x) would be attracted in the hands of Mr. Rajesh who has received immovable property, being a capital asset, for inadequate consideration. Therefore, **` 60 lakh,** being the difference between the stamp duty value of the property on the date of registration(i.e., ` 150 lakh) and the actual consideration (i.e., ` 90 lakh) would be taxable under section 56(2)(x) in the hands of Mr. Rajesh.

Note: As per section 43CA, stamp duty value on the date of agreement can be adopted, if whole or part of consideration is received otherwise than by way of cash on or before the date of agreement.

However, both section 50C and 56(2)(x) permit adoption of stamp value duty on the date of agreement only if whole or part of consideration is received/paid, as the case may be by way of account payee cheque or account payee bank draft or by use of ECS through a bank account.

Illustration 8

Interest on enhanced compensation received by Mr. G during the previous year 2017-18 is Rs.5,00,000. Out of this interest, Rs.1,50,000 relates to the previous year 2012-13, Rs. 1,65,000 relates to previous year 2013-14 and Rs.1,85,000 relates to previous year 2014-15. Discuss the tax implication, if any, of such interest income for A.Y.2018-19.

Solution

The entire interest of Rs. 5,00,000 would be taxable in the year of receipt, namely, P.Y.2017-18.

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. Rajendra 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".

EXERCISE

Question 1

Parimal, Managing Director of Heavens Engg. Pvt. Ltd. holds 70% of its paid up capital of Rs.20 Lacs. The balance as at 31.03.2017 in General Reserve was Rs.6 Lacs. The company on 1.07.2017 gave an interest-free loan of Rs.5 Lacs to its Supervisor having salary of Rs.4,000 p.m., who in turn on 15.8.2017 advanced the said amount of loan so taken from the company to Shri Parimal. The Assessing Officer had taxed the amount of advance in the hands of Parimal. Is the action of Assessing Officer correct?

Answer

The company had advanced a loan to an employee who in turn had advanced the same to the Managing Director of the company holding 70% of its capital. By virtue of the provisions of section 2(22)(e), the same shall be treated as the payment by a company in which public are not substantially interested, on behalf of, or for individual benefit of any such share holder (who holds not less than 10% of the voting power), to the extent to which the company possesses accumulated profits.

In this case, the company has reserves of Rs. 6 Lacs on 31st March of the preceding year and the amount of loan advanced on 1st July is Rs. 5 Lacs. Therefore, the payment is to be treated as deemed dividend. The amount of interest-free loan of Rs. 5 Lacs given by the company to the supervisor who in turn had given the same to Mr. Parimal, shall be construed as the amount given for the benefit of Mr. Parimal and is treated as deemed dividend chargeable to tax in the hands of Mr. Parimal. This has been held by the Supreme Court in the case of L. Alagusundaram Chettiar v. CIT (2001) 252 ITR 893.

Question 2

HLI Private Limited is a company with three shareholders H (40%), L (20%) and I on behalf of his HUF (40%). I (HUF) is a Hindu Undivided Family whose members are Mr. I, Mrs. I and their two sons, G and J. The company gave a loan of Rs.9 lakhs to I (HUF) on 30th April, 2017, on which date the accumulated profits of the company was Rs.6 lakhs. What is the tax consequence of this transaction?

Answer

The issue under consideration in this case is whether, where the Karta is a shareholder (on behalf of his HUF) of a company in which public are not substantially interested, the loan advanced by the company to the HUF would constitute deemed dividend under section 2(22)(e) to the extent to

which the company possesses accumulated profits.

There are two views on the basis of which this question can be answered.

First view

Section 2(22)(e) would be attracted if the loan is given by a company in which public are not substantially interested to a shareholder, being a person who is the beneficial owner of shares holding not less than 10% of voting power.

On a plain reading of section 2(22)(e), it appears that the said provision would be attracted only if the person to whom the loan is given is a registered shareholder as well as beneficial owner.

If this view is taken, then section 2(22)(e) would not be attracted in this case, since the registered shareholder is Mr. I (on behalf of his HUF), whereas the beneficial owner is his HUF.

Therefore, loan given to the HUF would not be deemed as dividend by applying section 2(22)(e).

Note –This view was taken by the Supreme Court in Rameshwarlal Sanwarmal v. CIT (1980) 122 ITR 1 (SC).

Second view

Section 2(22)(e) would be attracted if the loan is given by a company in which public are not substantially interested to a shareholder, being a person who is the beneficial owner of shares holding not less than 10% of voting power.

Even though on a plain reading of section 2(22)(e), it appears that the said provision would be attracted only if the person to whom the loan is given is a registered shareholder as well as beneficial owner, the Delhi High Court, in CIT v. National Travel Services (2012) 347 ITR 305/(2011) 202 Taxman 327, has taken a view that where loan is given by a company to a firm, being the beneficial owner of shares held in the name of its partners, provisions of section 2(22)(e) would be attracted, since the essential condition to be satisfied is that of beneficial ownership and it is not necessary that the beneficial owner has to be a registered shareholder.

If this view is adopted, then section 2(22)(e) would get attracted in this case. The loan to the HUF, being the beneficial owner, would be deemed as dividend in the hands of the HUF.

It would, however, be taxable only to the extent to which the company possesses accumulated profits on the date of loan i.e., in this case, Rs. 6 lakh.

Question 3

Mr. Santhanam holding 25% voting power in VKS Manufacturing Private Limited permitted his own land to be mortgaged to a bank for enabling the company to obtain a loan. Mr. Santhanam requested the company to release the property from the mortgage. The company failed to do so, but for retaining the benefit of bank loan it gave an advance of Rs.10 lakhs to Mr. Santhanam, which was authorized by a resolution passed by the Board of Directors. The company's accumulated profit on the date of payment of advance was Rs.50 lakhs. The Assessing Officer proposes to tax the amount of Rs.10 lakhs by invoking the provision of section 2(22)(e).

Is the proposition of the Assessing Officer correct in law?

Answer

The issue under consideration is whether loan or advance given to a shareholder by the company, in return of an advantage or benefit conferred on the company by the shareholder, can be deemed as dividend under section 2(22)(e) of the Income-tax Act, 1961 in the hands of the shareholder

The facts of the case are similar to the facts in Pradip Kumar Malhotra v. CIT (2011) 338 ITR 538, wherein the above issue came up before the Calcutta High Court.

The High Court observed that the phrase "by way of advance or loan" appearing in section 2(22)(e) must be construed to mean those advances or loans which a shareholder enjoys simply on account of being 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) holding not less than 10% of the voting power.

In case such loan or advance is given to such shareholder as a consequence of any further consideration received from such a shareholder which is beneficial to the company, such advance or loan cannot be a deemed dividend within the meaning of the Act.

Thus, gratuitous loan or advance given by a company to a shareholder, who is the beneficial owner of shares holding not less than 10% of the voting power, would come within the purview of section 2(22)(e) to the extent of accumulated profits of the company but not the cases where the loan or advance is given in return for an advantage conferred upon the company by such shareholder.

In this case, advance of Rs. 10 lakhs was given by VKS Manufacturing (P) Ltd. to Mr. Santhanam holding 25% of voting power in lieu of non-release of his personal property from mortgage thereby enabling the company to retain the benefit of loan obtained from bank. Therefore, applying the rationale of the Calcutta High Court ruling in Pradip Kumar Malhotra's case, such advance cannot be brought within the purview of section 2(22)(e), since it was not in the nature of gratuitous advance but was given to protect the interest of the company.

The proposition of the Assessing Officer to tax the amount of Rs. 10 lakhs by invoking the provisions of section 2(22)(e) in this case is, therefore, **not correct**.

Question 4

An enterprise engaged in manufacturing of steel balls discontinued its activities and decided to lease out its factory building, plant and machinery and furniture from 1.4.2017 on a consolidated lease rent of Rs.50,000 per month. Compute the income for Assessment Year 2018-19 of the assessee from following information:

		`
(i)	Interest received on deposits	1,00,000
(ii)	Brokerage paid on hundi loan taken	2,000
(iii)	Interest paid on hundi and other loans which were given as deposits on interest to others	75,000
(iv)	Expenses incurred on repairs of building, plant and machinery	15,000

(v) Fire insurance premium of plant and machinery and furniture 12,000

(vi) Depreciation for the year 1,47,500

(vii) Legal fees paid to an advocate for drafting and registering the lease agreement 1,500

(viii) Factory licence fees paid for the year 1,000

(ix) There is unabsorbed depreciation of Rs.2,75,000 of the Assessment Years 2016-17 and 2017-18.

(x) Interest paid includes an amount of Rs.25,000 remitted to a non-resident outside India on which tax was not deducted at source.

Answer

The income derived from leased assets shall be chargeable to tax as 'Income from other sources' under section 56(2)(iii) but the computation thereof shall be made after allowing deductions specified under sections 30, 31 and 32 subject to section 38. This is as per the provisions of section 57(ii) and 57(iii).

Computation of income under the head "Income from other sources"

Particulars	`	`
(A) Lease Rent for 12 months @ Rs. 50,000 p.m.		6,00,000
Less: Expenses and deductions allowable under section 57(ii) & 57(iii):		
Repairs	15,000	
Fire Insurance Premium	12,000	
Legal expenses for drafting of lease agreement	1,500	
Factory Licence fee	1,000	
Depreciation for the year	1,47,500	
Unabsorbed depreciation of earlier assessment years – eligible for deduction **(Note 1)**	2,75,000	4,52,000
		1,48,000
(B) Interest on Deposits	1,00,000	
Less: Expenses allowable under section 57(i) Brokerage Rs. 2,000 Interest on hundi loans **(Note 2)** Rs. 50,000	52,000	48,000
Total Income		**1,96,000**

Note:

1. Unabsorbed depreciation of Rs. 2,75,000 pertains to earlier assessment years. The unabsorbed depreciation shall form part of the current year depreciation and can be set off against any other head of income. Accordingly, the amount of Rs. 2,75,000 is adjustable / allowed to be set off against 'Income from other sources'.

2. Since deposits are made by investing amount received on hundi and other loans, the interest on hundi and other loans would be eligible for deduction from the income arising on such deposits.
3. Interest paid to non-resident is not eligible for deduction as the tax has not been deducted at source.

Question 5

In July 2017, Mr. Pervez employed as Marketing Manager in a Pharma company, received a Maruti car as gift from a distributor of the company. The value of the gifted car is estimated at Rs.2,60,000. Is the value of car taxable as income? If so, under what head it is taxable?

Answer

Mr. Pervez, an employee of a Pharma company, has received a car as a gift from a distributor of the company. Since there is no employer-employee relationship in this case between the distributor and Mr. Pervez, the value of gift is **not** a perquisite chargeable to tax under the head "Salaries".

Section 56(2)(x), brings within its scope the value of any property received by any person. 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.

Therefore, for the purpose of attracting the provisions of section 56(2)(x) for chargeability under the head "Income from Other Sources", an individual should be in receipt of property as defined therein. Since, car is not included in the definition of "property", the provisions of section 56(2)(x) would not be attracted in the hands of Mr. Pervez.

SIGNIFICANT SELECT CASES

1. What are the tests for determining "substantial part of business" of lending company for the purpose of application of exclusion provision under section 2(22)?

CIT v. Parle Plastics Ltd. (2011) 332 ITR 63 (Bom.)

High Court's Observations: Under section 2(22), "dividend" does not include, inter alia, any advance or loan made to a shareholder by a company in the ordinary course of its business, where the lending of money is a substantial part of the business of the company. The expression used in the exclusion provision of section 2(22) is "substantial part of the business". Sometimes a portion which contributes a substantial part of the turnover, though it contributes a relatively small portion of the profit, would be termed as a substantial part of the business. Similarly, a portion which is relatively small as compared to the total turnover, but generates a large portion, say, more than 50% of the total profit of the company would also be a substantial part of its business. Percentage of turnover in relation to the whole as also the percentage of the profit in relation to the whole and sometimes even percentage of manpower used for a particular part of the business in relation to the total manpower or work force of the company would be required to be taken into consideration for determining the substantial part of business. The capital employed for a specific division of a company in comparison to total capital employed would also be relevant to determine whether the part of the business constitutes a substantial part.

In this case, 42% of the total assets of the lending company were deployed by it by way of loans and advances. Further, if the income earned by way of interest is excluded, the other business had resulted in a net loss. These factors were considered in concluding that lending of money

High Court's Decision: Since lending of money was a substantial part of the business of the lending company, the money given by it by way of advance or loan to the assessee could not be regarded as a dividend, as it had to be excluded from the definition of "dividend" by virtue of the specific exclusion in section 2(22).

was a substantial part of the business of the company.

2. **Can repair and renovation expenses incurred by a company in respect of premises leased out by a shareholder having substantial interest in the company, be treated as deemed dividend?**

CIT v. Vir Vikram Vaid (2014) 367 ITR 365 (Bom)

Facts of the case: The assessee holds more than 75% of equity shares in a company and is the executive director of the company. In his personal capacity, he is the owner of certain premises in which he was carrying on a proprietary business. Subsequently, the assessee ceased to carry on the business of proprietary concern and hence, let out the premises to the company. The company incurred Rs. 2.51 crores towards construction and improvement of factory premises, which it continued to use otherwise than as the owner of the premises. The Assessing Officer held that the amounts spent by the company towards repair and renovation is taxable as deemed dividend in the hands of the assessee. In the alternative, the said amount was to be treated as a perquisite taxable in the hands of the assessee.

Appellate Authorities' Views: The Commissioner (Appeals) noted the assessee's submission that he had leased out the said premises for a rent lower than the prevailing market rate with an understanding that all expenditure for its upkeep and maintenance would be spent by the company on account of the assessee having stopped business activities. According to the Commissioner (Appeals), the assessee failed to substantiate his claim. The Commissioner (Appeals) was of the view that all the conditions provided under section 2(22)(e) for deemed dividend were satisfied. On the other hand, the Tribunal concluded that the payment was neither a deemed dividend nor a perquisite chargeable to tax. **High Court's Observations:** The challenge before the High Court by the Revenue was only with regard to applicability of section 2(22)(e) in this case. The High Court observed that no money had been paid by way of advance or loan to the shareholder who has substantial interest in the company. Further, the amount spent was towards repairs and renovation of the premises owned by the assessee but occupied by the company as lessee. There is no dispute that the company had taken on rent the aforesaid premises.

High Court's Decision: The High Court, accordingly, held that the repair and renovation expenses in respect of premises occupied by the company cannot be treated as deemed dividend in the hands of shareholder being the owner of the building.

The High Court observed that the expenditure incurred by virtue of repairs and renovation on the premises cannot be brought within the definition of advance or loan given to the shareholder having substantial interest in the company, though he is the owner of the premises. It cannot be treated as payment by the company on behalf of the shareholder or for the individual benefit of such shareholder. If held in such manner, it is a mere assumption not tenable in law.

3. **Can the loan or advance given to a shareholder by the company, in return for an advantage conferred on the company by the shareholder, be deemed as dividend under section 2(22)(e) in the hands of the shareholder?**

Pradip Kumar Malhotra v. CIT (2011) 338 ITR 538 (Cal.)

Facts of the case: In the present case, the assessee, a shareholder holding substantial voting power in the company, permitted his property to be mortgaged to the bank for enabling the company to take the benefit of loan. The shareholder requested the company to release the property from the mortgage. On failing to do so and for retaining the benefit of loan availed

from bank, the company gave advance to the assessee, which was authorized by a resolution passed by its Board of Directors.

Issue: The issue under consideration is whether the advance given by the company to the assessee-shareholder by way of security deposit for keeping his property as mortgage on behalf of company to reap the benefit of loan, can be treated as deemed dividend within the meaning of section 2(22)(e).

High Court's Observations: In the above case, the Calcutta High Court observed that, the phrase "by way of advance or loan" appearing in section 2(22)(e) must be construed to mean those advances or loans which a shareholder enjoys simply on account of being 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) holding not less than 10% of the voting power. In case such loan or advance is given to such shareholder as a consequence of any further consideration which is beneficial to the company received from such a shareholder, such advance or loan cannot be said to a deemed dividend within the meaning of the Act. Thus, gratuitous loan or advance given by a company to a shareholder, who is the beneficial owner of shares holding not less than 10% of the voting power, would come within the purview of section 2(22)(e) but not to the cases where the loan or advance is given in return to an advantage conferred upon the company by such shareholder.

High Court's Decision: In the present case, the advance given to the assessee by the company was not in the nature of a gratuitous advance; instead it was given to protect the interest of the company. Therefore, the said advance cannot be treated as deemed dividend in the hands of the shareholder under section 2(22)(e).

4. Would the provisions of deemed dividend under section 2(22)(e) be attracted in respect of financial transactions entered into in the normal course of business?

CIT v. Ambassador Travels (P) Ltd. (2009) 318 ITR 376 (Del.)

Under section 2(22)(e), loans and advances made out of accumulated profits of a company in which public are not substantially interested to a beneficial owner of shares holding not less than 10% of the voting power or to a concern in which such shareholder has substantial interest is deemed as dividend. However, this provision would not apply in the case of advance made in the course of the assessee's business as a trading transaction.

The assessee, a travel agency, has regular business dealings with two concerns in the tourism industry dealing with holiday resorts.

High Court's Observations & Decision: The High Court observed that the assessee was involved in booking of resorts for the customers of these companies and entered into normal business transactions as a part of its day-to-day business activities.

The High Court, therefore, held that such financial transactions cannot under any circumstances be treated as loans or advances received by the assessee from these concerns for the purpose of application of section 2(22)(e).

5. Can winnings of prize money on unsold lottery tickets held by the distributor of lottery tickets be assessed as business income and be subject to normal rates of tax instead of the rates prescribed under section 115BB?

CIT v. Manjoo and Co. (2011) 335 ITR 527 (Kerala)

High Court's Observations: On the above issue, the Kerala High Court observed that

winnings from lottery is included in the definition of income by virtue of section 2(24)(ix). Further, in practice, all prizes from unsold tickets of the lotteries shall be the property of the organising agent. Similarly, all unclaimed prizes shall also be the property of the organising agent and shall be refunded to the organising agent.

The High Court contended that the receipt of winnings from lottery by the distributor was not on account of any physical or intellectual effort made by him and therefore cannot be said to be "income earned" by him in business. The said view was taken on the basis that the unsold lottery tickets cease to be stock-in-trade of the distributor because, after the draw, those tickets are unsaleable and have no value except waste paper value and the distributor will get nothing on sale of the same except any prize winning ticket if held by him, which, if produced will entitle him for the prize money. Hence, the receipt of the prize money is not in his capacity as a lottery distributor but as a holder of the lottery ticket which won the prize. The Lottery Department also does not treat it as business income received by the distributor but instead treats it as prize money paid on which tax is deducted at source.

Further, winnings from lotteries are assessable under the special provisions of section 115BB, irrespective of the head under which such income falls. Therefore, even if the argument of the assessee is accepted and the winnings from lottery is taken to be received by him in the course of his business and as such assessable as business income, the specific provision contained in section 115BB, namely, the special rate of tax i.e. 30% would apply.

High Court's Decision: The High Court, therefore, held that the rate of 30% prescribed under section 115BB is applicable in respect of winnings from lottery received by the distributor.

Illustration 1

Mr. A is an employee of X Ltd. and he has 25% shares of that company. His salary is Rs.50,000 p.m. Mrs. A is working as a computer software programmer in X Ltd. at a salary of Rs.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.2018-19, 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 [Rs.50,000 × 12] = Rs.6,00,000

Gross total income of Mrs. A = Salary received by Mrs. A [Rs.30,000×12] = Rs.3,60,000

Illustration 3

Mr. B is an employee of Y Ltd. and has substantial interest in the company. His salary is Rs.20,000 p.m. Mrs. B is also working in Y Ltd. at a salary of Rs. 12,000 p.m. without any qualifications. Mr. B also receives Rs.30,000 as interest on securities. Mrs. B owns a house property which she has let out. Rent received from tenants is Rs.6000 p.m. Compute the gross total income of Mr. B and Mrs. B for the A.Y.2018-19.

Solution

Since Mrs. B is not professionally qualified for the job, the clubbing provisions shall be applicable.

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DT QUESTION BANK BY YNB

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

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Computation of Gross total income of Mrs. B

Particulars	`	`
Income from Salary [clubbed in the hands of Mr. B]		Nil
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**

Illustration 4

Mr. Vaibhav started a proprietary business on 01.04.2016 with a capital of Rs.5,00,000. He incurred a loss of Rs.2,00,000 during the year 2016-17. To overcome the financial position, his wife Mrs. Vaishaly, a software Engineer, gave a gift of Rs.5,00,000 on 01.04.2017, which was immediately invested in the business by Mr. Vaibhav. He earned a profit of Rs.4,00,000 during the year 2017-18. Compute the amount to be clubbed in the hands of Mrs. Vaishaly for the Assessment Year 2018-19. If Mrs. Vaishaly gave the said amount as loan, what would be the amount to be clubbed?

Solution

Section 64(1)(iv) of the Income-tax Act, 1961 provides for the clubbing of income in the hands of the individual, if the income earned is from the assets (other than house property) transferred directly or indirectly to the spouse of the individual, otherwise than for adequate consideration or in connection with an agreement to live apart.

In this case, Mr. Vaibhav received a gift of Rs.5,00,000 on 1.4.2017 from his wife Mrs. Vaishaly, which he invested in his business immediately. The income to be clubbed in the hands of Mrs. Vaishaly for the A.Y. 2018-19 is computed as under:

Particulars	Mr. Vaibhav's capital contribution (`)	Capital contribution out of gift from Mrs. Vaishaly (`)	Total (`)
Capital as on 1.4.2017	3,00,000 (5,00,000 – 2,00,000)	5,00,000	8,00,000

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Profit for P.Y.2017-18 to be apportioned on the basis of capital employed on the first day of the previous year i.e. as on 1.4.2017 (3:5)	1,50,000 $\left(4,00,000 \times \frac{3}{8}\right)$	2,50,000 $\left(4,00,000 \times \frac{5}{8}\right)$	4,00,000

Therefore, the income to be clubbed in the hands of Mrs. Vaishaly for the A.Y.2018-19 is Rs.2,50,000.

In case Mrs. Vaishaly gave the said amount of Rs.5,00,000 as a bona fide loan, then, clubbing provisions would not be attracted.

Note: The provisions of section 56(2)(x) would not be attracted in the hands of Mr. Vaibhav, since he has received a sum of money exceeding Rs.50,000 without consideration from a relative i.e., his wife.

Illustration 5

Mrs. Kasturi transferred her immovable property to ABC Co. Ltd. subject to a condition that out of the rental income, a sum of Rs.36,000 per annum shall be utilized for the benefit of her son's wife.

Mrs. Kasturi claims that the amount of Rs.36,000 (utilized by her son's wife) should not be included in her total income as she no longer owned the property.

Examine with reasons whether the contention of Mrs. Kasturi is valid in law.

Solution

The clubbing provisions under section 64(1)(viii) are attracted in case of transfer of any asset, directly or indirectly, otherwise than for adequate consideration, to any person to the extent to which the income from such asset is for the immediate or deferred benefit of son's wife. Such income shall be included in computing the total income of the transferor-individual.

Therefore, income of Rs.36,000 meant for the benefit of daughter-in-law is chargeable to tax in the hands of transferor i.e., Mrs. Kasturi in this case.

The contention of Mrs. Kasturi is, hence, not valid in law.

Note **-** *In order to attract the clubbing provisions under section 64(1)(viii), the transfer should be otherwise than for adequate consideration. In this case, it is presumed that the transfer is otherwise than for adequate consideration and therefore, the clubbing provisions are attracted.*

If it is presumed that the transfer was for adequate consideration, the provisions of section 64(1)(viii) would not be attracted.

Illustration 6

Mr. A has three minor children – two twin daughters and one son. Income of the twin daughters is Rs.2,000 p.a. each and that of the son is Rs.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

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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**

Illustration 7

Mr. Vasudevan gifted a sum of Rs.6 lakhs to his brother's wife on 14-6-2017. On 12-7-2017, his brother gifted a sum of Rs.5 lakhs to Mr. Vasudevan's wife. The gifted amounts were invested as fixed deposits in banks by Mrs. Vasudevan and wife of Mr. Vasudevan's brother on 01-8-2017 at 9% interest. Discuss the consequences of the above under the provisions of the Income-tax Act, 1961 in the hands of Mr. Vasudevan and his brother.

Solution

In the given case, Mr. Vasudevan gifted a sum of Rs.6 lakhs to his brother's wife on 14.06.2017 and simultaneously, his brother gifted a sum of Rs.5 lakhs to Mr. Vasudevan's wife on 12.07.2017. The gifted amounts were invested as fixed deposits in banks by Mrs. Vasudevan and his brother's wife.

These transfers are in the nature of cross transfers. Accordingly, the income from the assets transferred would be assessed in the hands of the deemed transferor because the transfers are so intimately connected to form part of a single transaction and each transfer constitutes consideration for the other by being mutual or otherwise.

If two transactions are inter-connected and are part 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. It was so held by the Apex Court in CIT vs. Keshavji Morarji (1967) 66 ITR 142.

Accordingly, the interest income arising to Mrs. Vasudevan in the form of interest on fixed deposits would be included in the total income of Mr. Vasudevan and interest income arising in the hands of his brother's wife would be taxable in the hands of Mr. Vasudevan's brother as per section 64(1), to the extent of amount of cross transfers i.e., Rs.5 lakhs.

This is because both Mr. Vasudevan and his brother are the indirect transferors of the income to their respective spouses with an intention to reduce their burden of taxation.

However, the interest income earned by his spouse on fixed deposit of Rs.5 lakhs alone would be included in the hands of Mr. Vasudevan's brother and not the interest income on the entire fixed deposit of Rs.6 lakhs, since the cross transfer is only to the extent of Rs.5 lakhs.

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Illustration 8

Mr. Ravi has gifted his only house property to his wife, Mrs. Ravi, and his married daughter, Mrs. Divya. The Assessing Officer has served a notice of demand on Mr. Ravi for payment of tax for the income derived from the said house property. Examine the validity of the Assessing Officer's action.

Answer

As per section 27(i), an individual who transfers otherwise than for adequate consideration any house property to his spouse, not being a transfer in connection with an agreement to live apart, or to a minor child not being a married daughter shall be deemed to be the owner of the house property so transferred.

Mr. Ravi, in this case, would be the deemed owner only in respect of the share of house property transferred to his wife Mrs. Ravi without consideration and not for the share of the house property transferred to his married daughter Mrs. Divya.

Since Mr. Ravi is the deemed owner of the share of house property transferred to his wife without consideration, the income derived from the house property, to the extent attributable to the share of property transferred to his wife without consideration, would be taxable in his hands under the head "Income from house property".

As per section 65, the notice of demand can, however, be served on Mrs. Ravi for payment of that portion of tax levied on Mr. Ravi attributable to the income derived [by virtue of section 27(i)], from the share of house property transferred to Mrs. Ravi, and standing in her name.

However, the income derived from house property, attributable to the share of property transferred to his married daughter without consideration, would be taxable in the hands of his daughter. Such income would not be taxable in the hands of Mr. Ravi. Mr. Ravi will not be responsible for the payment of tax attributable to aforesaid share of income of daughter from house property.

Thus, the action of the Assessing Officer in serving notice of demand on Mr. Ravi for payment of tax for the entire income derived from the said house property is not valid.

EXERCISE

Question 1

Mrs. E, wife of Mr. F, is a partner in a firm. Her capital contribution to the firm as on 01-04-2017 was Rs.5 lacs, out of which Rs.3 lacs was contributed out of her own sources and

Rs.2 lacs was contributed out of gift from her husband.

As further capital was needed by the firm, she further invested Rs.2 lacs on 01.05.2017 out of the funds gifted by her husband. The firm paid interest on capital of Rs.80,000 and share of profit of

Rs.60,000 for the financial year 2017-18.

Advise Mr. F as to the applicability of the provisions of section 64(1)(iv) and the manner thereof in respect of the above referred transactions.

Answer

As per section 64(1)(iv), in computing the total income of any individual, there shall be included all such income as arises, directly or indirectly, subject to the provisions of section 27(i), to the spouse of such individual from assets transferred directly or indirectly to the spouse by such individual otherwise than for adequate consideration or in connection with an agreement to live apart.

In this instant case, Mr. F has gifted money to his wife, Mrs. E. Mrs. E, in turn, invested such gifted

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money in the capital of a partnership firm, of which she is a partner. Mrs. E has also contributed a sum of Rs.3 lacs out of her own resources to the capital of the firm.

As per Explanation 3 to section 64(1), for the purpose of clubbing under section 64(1)(iv), where the assets transferred, directly or indirectly, by an individual to his spouse are invested by the transferee in the nature of contribution of capital as a partner in a firm, 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 by way of capital contribution as a partner in the firm as on that day.

In view of the above provision, interest received by Mrs. E from the firm shall be included in total income of Mr. F to the extent of Rs.32,000 i.e., Rs.80,000 x Rs.2,00,000/ Rs.5,00,000.

Share of profit amounting to Rs.60,000 is exempt from income-tax under the provisions of section 10(2A). The provisions of section 64 will not apply, if the income from the transferred asset itself is exempt from tax.

Note: It is assumed that rate of interest on capital contributed by Mrs. E does not exceed 12% p.a.

Question 2

Mr. A has gifted a house property valued at Rs.50 lakhs to his wife, Mrs. B, who in tum has gifted the same to Mrs. C, their daughter-in-law. The house was let out at Rs.25,000 per month throughout the year. Compute the total income of Mr. A and Mrs. C.

Will your answer be different if the said property was gifted to his son, husband of Mrs. C?

Answer

As per section 27(i), an individual who transfers otherwise than for adequate consideration any house property to his spouse, not being a transfer in connection with an agreement to live apart, shall be deemed to be the owner of the house property so transferred.

Therefore, in this case, Mr. A would be the deemed owner of the house property transferred to his wife Mrs. B without consideration.

As per section 64(1)(vi), income arising to the son's wife from assets transferred, directly or indirectly, to her by an individual otherwise than for adequate consideration would be included in the total income of such individual.

Income from let-out property is Rs.2,10,000 [i.e., Rs.3,00,000, being the actual rent calculated at Rs.25,000 per month less Rs.90,000, being deduction under section 24 @30% of Rs.3,00,000]

In this case, income of Rs.2,10,000 from let-out property arising to Mrs. C, being Mr. A's son's wife, would be included in the income of Mr. A, applying the provisions of section 27(i) and section 64(1)(vi). Such income would, therefore, not be taxable in the hands of Mrs. C.

In case the property was gifted to Mr. A's son, the clubbing provisions under section 64 would not apply, since the son is not a minor child. Therefore, the income of Rs.2,10,000 from letting out of property gifted to the son would be taxable in the hands of the son.

It may be noted that the provisions of section 56(2)(x) would not be attracted in the hands of the recipient of house property, since the receipt of property in each case was from a "relative" of such individual. Therefore, the stamp duty value of house property would not be chargeable to tax in the hands of the recipient of immovable property, even though the house property was received by her or him without consideration.

Note - The first part of the question can also be answered by applying the provisions of section 64(1)(vi) directly to include the income of Rs.2,10,000 arising to Mrs. C in the hands of Mr. A.

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[without first applying the provisions of section 27(i) to deem Mr. A as the owner of the house property transferred to his wife Mrs. B without consideration], since section 64(1)(vi) speaks of clubbing of income arising to son's wife from indirect transfer of assets to her by her husband's parent, without consideration. Gift of house property by Mr. A to Mrs. C, via Mrs. B, can be viewed as an indirect transfer by Mr. A to Mrs. C.

Question 3

Mr. Korani transferred 2,000 debentures of Rs.100 each of Wild Fox Ltd. to his wife Mrs. Rekha Korani on 3.10.2016 without consideration. The company paid interest of Rs.30,000 in September, 2017 which was deposited by Mrs. Korani with Kartar Finance Co. in October, 2017 Kartar Finance Co. paid interest of Rs.3,000 upto March, 2018. How would both the interest income be charged to tax in A.Y. 2018-19?

Answer

As per section 64(1)(iv), income arising from assets transferred without adequate consideration by an individual to his spouse is liable to be clubbed in the hands of the individual. It may be noted that income on the asset transferred has to be clubbed but if there is accretion to the asset, any further income derived on such accretion should not be clubbed.

Therefore, applying the provisions of section 64(1)(iv), Rs.30,000, being the interest on debentures received by Mrs. Rekha Korani in September, 2017 will be clubbed with the income of Mr. Korani, since he had transferred the debentures of the company without consideration to her in October, 2016.

However, the interest of Rs.3,000 upto March, 2018 earned by Mrs. Rekha Korani on the interest on the debentures deposited by her with Kartar Finance Company shall be taxable in her individual capacity and will not be clubbed with the income of Mr. Korani.

Question 4

Mr. Rose, out of his own funds, had taken an FDR for Rs.10,00,000 bearing interest @10% p.a. payable half-yearly in the name of his wife Lilly. The interest earned during the financial year 2017- 18 of Rs.1,00,000 was invested by Mrs. Lilly in the business of packed spices which resulted in a net profit of Rs.55,000 for the year ended 31.03.2018. How shall the interest on FDR and income from business be taxed for the Assessment Year 2018-19?

Answer

Section 64(1)(iv) specifies that the income derived by the spouse of an assessee from the assets transferred directly or indirectly without adequate consideration or intention to live apart shall be clubbed with the income of the transferor. Therefore, the interest income of Rs.1 lac on the FDR of Rs.10 lacs for the F.Y.2017-18 shall be clubbed with the income of Mr. Rose.

When Mrs. Lilly invested the interest income in a business and earned profits therefrom, such profits shall not be clubbed with the income of her husband but shall be taxable in her individual capacity. This is so because the income from the accretion of the transferred assets is not to be clubbed with the income of the transferor [CIT v. M. S. S. Rajan (2001) 252 ITR 126 (Mad)].

Question 5

Naresh is a fashion designer having lucrative business. His wife is a model. Naresh pays her monthly salary of Rs.10,000. The Assessing Officer while admitting that the salary is an admissible deduction, in computing the total income of Naresh had applied the provisions of section 64(1), and had clubbed the income (salary) of his wife in Naresh hands.

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Discuss the correctness of the action of the Assessing Officer.

Answer

This question is based on the principles laid down by Madras High Court in the case of CIT v. Smt. R. Bharati (1999) 240 ITR 697 where the interpretation of the terms "professional qualifications" and "knowledge" came up for consideration as per proviso to section 64(1).

These words do not necessarily connote a qualification conferred by a recognized university after examining the candidate who has undergone a course of study in a technical subject or course of study preparing him for a profession of law, accountancy etc. Accordingly, the term "qualification" must be given a wide meaning as referring to the qualities which are required to be possessed by a person performing the work that he does, so long as that work is capable of being regarded as technical or professional.

The word "professional" is a term capable of very broad meaning and would encompass a variety of occupations. A large number of occupations are being practiced which form a source of livelihood and are capable of being regarded, as professions as long as they require certain degree of skill. A person having skill, experience and competence in a line of work can be regarded as professionally qualified for the purpose of section 64(1)(ii).

Applying the rationale of the Madras High Court ruling, a model, having skill, competence and experience in her line can be considered as a professional. Hence, the action of the Assessing Officer is not correct.

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Illustration 1

Mr. A submits the following particulars pertaining to the A.Y.2018-19:

Particulars	*`Amount*
Income from salary	*4,00,000*
Loss from self-occupied property	*(-)70,000*
Loss from let-out property	*(-) 1,50,000*
Business loss	*(-)1,00,000*
Bank interest (FD) received	*80,000*

Compute the total income of Mr. A for the A.Y.2018-19.

Solution

Computation of total income of Mr. A for the A.Y.2018-19

Particulars	Amount (`)	Amount (`)
Income from salary	4,00,000	
Loss from house property of Rs.2,20,000 to be restricted to Rs.2 lakhs by virtue of section 71(3A) Balance loss of Rs.20,000 from house property to be carry forward to next assessment year	(-) 2,00,000	2,00,000
Income from other sources (interest on fixed deposit with bank)		
Business loss set-off Business loss of ` 20,000 to be carried forward		
Gross total income [See Note below]		
Less: Deduction under Chapter VI-A		
Total income		

r adjusting loss of
om house property will be carried
erest of Rs.80,000 and remaining business loss of Rs.20,000 will be carried forward as it cannot be set off against salary income.

Illustration 2

Particulars	`
Income from salary (Net)	*45,000*
Income from house property	*(24,000)*
Income from business – non-speculative	*(22,000)*
Income from speculative business	*(4,000)*
Short-term capital losses	*(25,000)*
Long-term capital gains	*19,000*

Mr. B, a resident individual, furnishes the following particulars for the P.Y.2017-18:
What is the total income chargeable to tax for the A.Y.2018-19?

Solution

Total income of Mr. B for the A.Y. 2018-19

Particulars	Amount (`)	Amount (`)
Income from salaries	45,000	
Income from house property	(24,000)	21,000
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 Rs.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 Rs.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 Rs.25,000 can be set-off against long- term capital gains to the extent of Rs.19,000. The balance short term capital loss of Rs.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.

Illustration 3

During the P.Y. 2017-18, 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.2016-17	*(96,000)*
Short term capital loss of A.Y.2017-18	*(37,000)*
Long term capital gain	*75,000*

What is the capital gain taxable in the hands of Mr. C for the A.Y.2018-19?

Solution

Taxable capital gains of Mr. C for the A.Y. 2018-19

Particulars	`	`
Short term capital gains on sale of shares	1,50,000	
Less: Brought forward short term capital loss of the A.Y.2017-18	(37,000)	1,13,000
Long term capital gain	75,000	
Less: Brought forward long term capital loss of A.Y.2016-17 **[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.2016-17of Rs.21,000 (i.e. Rs.96,000 – Rs.75,000) has to be carried forward to the next year to be set-off against long-term capital gains of that year.

Illustration 4

Mr. D has the following income for the P.Y.2017-18-

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.2015-16)	96,000

What is the total income in the hands of Mr. D for the A.Y. 2018-19?

Solution

Total income of Mr. D for the A.Y. 2018-19

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	96,000	
Loss from the activity of owning and maintaining race horses to be carried forward to A.Y.2019-20	(21,000)	
Income from textile business	85,000	
Less: Brought forward business loss from textile business.	50,000	35,000
Total 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.

Illustration 5

Mr. E has furnished his details for the A.Y.2018-19 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.2016-17	*(30,000)*
Winning from lotteries	*20,000*

What is the taxable income of Mr. E for the A.Y.2018-19?

Solution

Computation of taxable income of Mr. E for the A.Y.2018-19

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 Rs.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.2018-19 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.2015-16)	*(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

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
Gross Total Income		**2,93,000**

Gross Total Income of Mr. F for the A.Y. 2018-19

Notes:

(1) Dividend from Indian companies of Rs.80,000 is exempt from tax under section 10(34).

(2) 60% of the income from tea business is treated as agricultural income and therefore, exempt from tax;

(3) Long-term capital loss can be set-off only against long-term capital gains. Therefore, long-term capital loss of Rs.90,000 brought forward from A.Y.2015-16 cannot be set-off in the A.Y.2018-19. It has to be carried forward for set-off against long-term capital gains, if any, during A.Y.2019-20.

EXERCISE

Question 1

X carrying on a business as sole proprietor, died on 31st March, 2017. On his death, the same business was continued by his legal heirs, by forming a firm. As on 31st March 2017, a determined business loss of Rs.5 lacs is to be carried forward under the Income-tax Act, 1961.

Does the firm consisting of all legal heirs of Mr. X, get a right to have this loss adjusted against its current income?

Answer

Section 78(2) provides that where a person carrying on any business or profession has been succeeded in such capacity by another person, otherwise than by inheritance, then, the successor is not entitled to carry forward and set-off the loss of the predecessor against his income. This implies that generally, set-off of business losses should be claimed by the same person who suffered the loss and the only exception to this provision is when the business passes on to another person by inheritance.

The facts of case given in the question are similar to the case CIT v. Madhukant M. Mehta (2001) 247 ITR 805, where the Supreme Court has held that if the business is succeeded by inheritance, the legal heirs are entitled to the benefit of carry forward of the loss of the predecessor. Even if the legal heirs constitute themselves as a partnership firm, the benefit of carry forward and set off of the loss of the predecessor would be available to the firm.

In this case, the business of X was continued by his legal heirs after his death by constituting a firm. Hence, the exception contained in section 78(2) along with the decision of the Apex Court discussed above, would apply in this case. Therefore, the firm is entitled to carry forward the business loss of Rs.5 lacs of X.

Question 2

ABC Limited was amalgamated with XYZ Limited on 01.04.2017. All the conditions of section 2(1B) were satisfied.

ABC Limited has the following carried forward losses as assessed till the Assessment Year 2017-18:

	Particulars	*` (in lacs)*
(i)	*Speculative Loss*	*4*
(ii)	*Unabsorbed Depreciation*	*18*
iii)	Unabsorbed expenditure of capital nature on scientific research	2

(iv)	Business Loss	120

XYZ Limited has computed a profit of Rs.140 lacs for the financial year 2017-18 before setting off the eligible losses of ABC Limited but after providing depreciation at 15% per annum on Rs.150 lacs, being the consideration at which plant and machinery were transferred to XYZ Limited.

The written down value as per income-tax record of ABC Limited as on 31st March, 2017 was Rs.100 lacs.

The above profit of XYZ Limited includes speculative profit of Rs.10 lacs.

Compute the total income of XYZ Limited for Assessment Year 2018-19 and indicate the losses/other allowances to be carried forward by it.

Answer :

Particulars	` (in lacs)	
Business income		
Business income before setting-off brought forward losses of ABC Ltd.		140
Add: Excess depreciation claimed in the scheme of amalgamation of ABC Limited with XYZ Limited.		
Value at which assets are transferred by ABC Ltd.	150	
WDV in the books of ABC Ltd.	100	
Excess accounted	50	
Excess depreciation claimed in computing taxable income of XYZ Ltd. [` 50 lacs × 15 %] [*Explanation 2* to section 43(6)]		7.50
		147.50
Set-off of brought forward business loss of ABC Ltd. **(See Notes 2 & 4)**		(120.00)
Set-off of unabsorbed depreciation under section 32(2) read with section 72A **(See Notes 2 & 4)**		(18.00)
Set-off of unabsorbed capital expenditure under section 35(1)(iv) read with section 35(4) **(See Note 5)**		(2.00)
		7.50

Notes:

1. It is presumed that the amalgamation is within the meaning of section 72A of the Income-tax Act, 1961.
2. In the case of amalgamation of companies, the unabsorbed losses and unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or unabsorbed depreciation of the amalgamated company for the previous year in which the amalgamation was effected and such business loss and unabsorbed depreciation shall be carried forward and set-off by the amalgamated company for a period of 8 years and indefinitely, respectively.
3. As per section 72A(7), the accumulated loss to be carried forward specifically excludes loss sustained in a speculative business. Therefore, speculative loss of Rs.4 lacs of ABC Ltd. cannot be carried forward by XYZ Ltd.
4. Section 72(2) provides that where any allowance or part thereof unabsorbed under section 32(2) (i.e., unabsorbed depreciation) or section 35(4) (i.e., unabsorbed scientific research capital expenditure) is to be carried forward, effect has to be first given to brought forward business losses under section 72.
5. Section 35(4) provides that the provisions of section 32(2) relating to unabsorbed depreciation shall apply in relation to deduction allowable under section 35(1)(iv) in respect of capital expenditure on scientific research related to the business carried on by the assessee. Therefore, unabsorbed capital expenditure on scientific research can be set-off and carried forward in the same manner as unabsorbed depreciation.
6. The restriction contained in section 73 is only regarding set-off of loss computed in respect of speculative business. Such a loss can be set-off only against profits of another speculation business and not non-speculation business. However, there is no restriction under the Income-tax Act, 1961 regarding set-off of normal business losses against speculative income. Therefore, normal business losses can be set-off against profits of a speculative business.

   Consequently, there is no loss or allowance to be carried forward by XYZ Ltd. to the F.Y. 2018-19.

Question 3

Examine in brief about the treatment to be given in the following case under the Income-tax Act, 1961, for A.Y.2018-19:

A loss of Rs.85,000 was sustained by Simran in the activity of owning and maintaining camels for races.

Answer

Sec 74A(3) lays down the provisions for set-off and carry forward of loss from the activity of owning and maintaining race horses. 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. Since the scope of this section is confined to the activity of owning and maintaining race horses only, therefore, set-off and carry forward of loss from the activity of owning and

maintaining camels is not covered under section 74A(3).

It is possible to take a view that the loss from the activity of owning and maintaining camels for races may be governed by section 72 provided such activity amounts to business. Accordingly, the loss from the activity of owning and maintaining of camels for races can be set-off against any income (other than income from salary) of current year and unadjusted amount shall be carried forward for set off against any business income for a maximum period of 8 assessment years immediately succeeding the assessment year in which the loss was incurred.

Question 4

M/s. JKLM, a firm, consists of four partners namely, J, K, L and M. They shared profits and losses equally during the year ended 31.3.2017. The assessed business loss of the firm for the assessment year 2017-18 which it is entitled to carry forward amounts to Rs.3,60,000. A new deed of partnership was executed among J, K, L and M on 1.4.2017 in terms of which they agreed to share profits and losses in the ratio of 15:15:20:50 respectively.

Compute the amount of business loss relating to the assessment year 2017-18, which the firm is entitled to set off against its business income for the assessment year 2018-19. The business income of the firm for the assessment year 2018-19 is Rs.3,30,000. Your answer should be supported by reasons.

Answer

The firm is entitled to set off its brought forward business loss amounting to Rs.3,60,000 relating to the assessment year 2017-18 to the extent of Rs.3,30,000 against its business income of Rs.3,30,000 for the assessment year 2018-19, as per the provisions of section 72(1).

The balance unabsorbed business loss of Rs.30,000 relating to the assessment year 2017-18 will be carried forward to assessment year 2019-20.

Section 78(1) which deals with carry forward and set-off of losses in the case of change in constitution of firm is applicable only where there is retirement or death of a partner. **It is not applicable to a case where there is a change in the ratio of sharing profits and losses amongst the existing partners.** Therefore, section 78(1) is not applicable to the case of M/s. JKLM.

Question 5

An assessee sustained a loss under the head "Income from house property" in the previous year relevant to the assessment year 2017-18, which could not be set off against income from any other head in that assessment year. The assessee did not furnish the return of loss within the time allowed under section 139(1) in respect of the relevant assessment year. However, the assessee filed the return within the time allowed under section 139(4). Can the assessee carry forward such loss for set off against income from house property of the assessment year 2018-19?

Answer

Section 139(3) stipulates that an assessee claiming carry forward of loss under the heads "Profits and gains of business or profession" or "Capital gains" should furnish the return of loss within the time stipulated under section 139(1). There is no reference to loss under the head

"Income from house property" in section 139(3). The assessee, in the instant case, has filed the return showing loss from property within the time prescribed under section 139(4). The assessee is, therefore, entitled to carry forward such loss for set off against the income from house property of the subsequent assessment year.

SIGNIFICANT SELECT CASES

Can the loss suffered by an erstwhile partnership firm, which was dissolved, be carried forward for set-off by the individual partner who took over the business of the firm as a sole proprietor, considering the succession as a succession by inheritance?
Pramod Mittal v. CIT (2013) 356 ITR 456 (Delhi)

Facts of the case: In the present case, the assessee was previously a partner in a firm. As per the dissolution deed of the partnership firm, with effect from 18th September, 2004, he took over the entire business of the partnership firm in his individual capacity including fixed assets, current assets and liabilities and the other partner was paid his dues. He then ran the business as a sole proprietor with effect from that date. The assessee, relying upon section 78(2) and the decisions of the Supreme Court in CIT v. Madhukant M. Mehta (2001) 247 ITR 805 (SC) and Saroj Aggarwal v. CIT (1985) 156 ITR 497 (SC), claimed the set-off of the losses suffered by the erstwhile partnership firm against his income earned as an individual proprietor, considering the case as inheritance of business.

However, considering that only the person who has suffered the loss is entitled to carry forward and set-off the same, the claim of the assessee was disallowed by the Assessing Officer. The Tribunal concurred with the Assessing Officer's view.

High Court's Observations: The High Court observed that upon dissolution, the partnership firm ceased to exist. Also, the partnership firm and the proprietorship concern are two separate and distinct units for the purpose of assessment. As per section 170(1), the partnership firm shall be assessed as such from 1st April of the previous year till the date of dissolution (i.e., 18th September, 2004). Thereafter, the income of the sole-proprietorship shall be taxable in the hands of the assessee as an individual. Thus, section 170(1) provides as to who will be assessable in respect of the income of the previous year from business, when there is a change in the person carrying on business by succession.

Section 78(2), however, deals with carry forward of losses in case of succession of business. It provides that only the person who has incurred the losses, and no one else, would be entitled to carry forward the same and set it off. An exception provided thereunder is in the case of succession by inheritance.

Therefore, section 170(1) providing the person in whose hands income is assessable in case of succession and section 78(2) providing for carry forward of losses in case of succession of business, deal with different situations and resultantly, there is no contradiction between these sections.

The income earned by the sole proprietor would include his share of loss as an individual but not the loss suffered by the erstwhile partnership firm in which he was a partner. The exception given in section 78(2), permitting carry forward of losses by the successor in case

of inheritance, is not applicable in the present case since the partnership firm was dissolved and ceased to continue. Taking over of business by a partner cannot be considered as a case of inheritance due to death as per the law of succession. The High Court opined that the decision in Madhukant M. Mehta's case and Saroj Aggarwal's case cannot be applied since this is not a case of succession by inheritance.

High Court's Decision: Therefore, the loss suffered by the erstwhile partnership firm before dissolution of the firm cannot be carried forward by the successor sole-proprietor, since it is not a case of succession by inheritance. The assessee sole-proprietor is, therefore, not entitled to set-off the loss of the erstwhile partnership firm against his income.

Note - *In Madhukant M. Mehta's case, the sole proprietor had expired and after his death the heirs succeeded the business as a partnership concern. Therefore, the losses suffered by the deceased proprietor was allowed to be set-off by the partnership firm since the case falls within the exception mentioned under section 78(2), i.e., a case of succession by inheritance.*

Also, in Saroj Aggarwal's case, upon death of a partner, his legal heirs were inducted as partners in the partnership firm. The partnership firm was not dissolved on the death of the partner. The partnership firm which suffered the losses continued with induction of the legal heirs of the deceased partner. This, being a case of succession by inheritance, the benefit of carry forward of losses was given to the re-constituted partnership firm.

In the present case, however, the partnership firm was dissolved and the take over of the running business of the firm by the erstwhile partner as a sole proprietor was not a case of succession by inheritance. Hence, the carry forward of losses of the firm by the sole proprietor was not allowed in this case.

Illustration 1

Examine the following statements with regard to the provisions of the Income-tax Act, 1961:

(a) For grant of deduction under section 80-IB, filing of audit report in prescribed form is must for a corporate assessee; filing of return within the due date laid down in section 139(1) is not required.

(b) Filing of belated return under section 139(4) of the Income-tax Act, 1961 will debar an assessee from claiming deduction under section 80-IE.

Solution

(a) **The statement is not correct.** 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 the benefit of deduction, inter alia, under section 80-IB.

(b) **The statement is correct.** As per section 80AC, the assessee has to furnish his return of income on or before the due date specified under section 139(1), to be eligible to claim deduction under, inter alia, section 80-IE.

Section 80B(5)

Illustration 2

Compute the eligible deduction under section 80C for A.Y.2018-19 in respect of life insurance premium paid by Mr. Ganesh during the P.Y.2017-18, the details of which are given hereunder -

	Date of issue of policy	Person insured	Actual capital sum assured (`)	Insurance premium paid during 2017-18 (`)
(i)	1/4/2011	Self	3,00,000	40,000
(ii)	1/5/2014	Spouse	1,50,000	20,000
(iii)	1/6/2015	Handicapped Son (section 80U disability)	4,00,000	80,000

Solution

	Date of issue of policy	Person insured	Actual capital sum assured (`)	Insurance premium paid during 2017-18 (`)	Deduction u/s 80C for A.Y.2018-19 (`)	Remark (restricted to % of sum assured)
(i)	1/4/2011	Self	3,00,000	40,000	40,000	20%
(ii)	1/5/2014	Spouse	1,50,000	20,000	15,000	10%
(iii)	1/6/2015	Handicapped son (section 80U disability)	4,00,000	80,000	60,000	15%
				Total	**1,15,000**	

Illustration 3

Mr. A, aged about 61 years, has earned a lottery income of Rs.1,20,000 (gross) during the P.Y. 2017-18. He also has interest on Fixed Deposit of Rs.30,000. He invested an amount of Rs.10,000 in Public Provident Fund account and Rs.24,000 in National Saving Certificates. What is the total income of Mr. A for the A.Y.2018-19?

Solution

Computation of total income of Mr. A for A.Y.2018-19

Particulars	`	`
Income from other sources		
- Interest on Fixed Deposit		30,000
- 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	
Restricted to		30,000
Total Income		**1,20,000**

Note: Though the value of eligible investments is Rs.34,000, however, deduction 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 = Rs.1,50,000 – Rs.1,20,000 = Rs.30,000.

(2) Deduction in respect of contribution to certain pension funds [Section 80CCC]

Illustration 4

An individual assessee, resident in India, has made the following deposit/payment during the previous year 2017-18:

Particulars	`
Contribution to the public provident fund	1,50,000
Insurance premium paid on the life of the spouse (policy taken on 1.4.2014) (Assured value Rs.2,00,000)	25,000

What is the deduction allowable under section 80C for A.Y.2018-19?

Solution

Computation of deduction under section 80C for A.Y.2018-19

Particulars	`
Deposit in public provident fund	1,50,000
Insurance premium paid on the life of the spouse (Maximum 10% of the assured value Rs.2,00,000, as the policy is taken after 31.3.2012)	20,000
Total	**1,70,000**
However, the maximum permissible deduction u/s 80C is restricted to	1,50,000

Note: As per section 80CCE, the aggregate deduction under section 80C, 80CCC and 80CCD(1) cannot exceed Rs.1,50,000.

Illustration 5

The basic salary of Mr. A is Rs.1,00,000 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. Examine 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

(a) 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, Rs.1,80,000, being 15% of basic salary of Rs.12,00,000, will be included in Mr. A's salary.

(b) 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 under section 80CCD for Mr. A would be –

Particulars	`
Basic salary = Rs.1,00,000 × 12 =	12,00,000
Dearness allowance = 40% of Rs.12,00,000 = Rs.4,80,000	
50% of Dearness Allowance forms part of pay = 50% of Rs.4,80,000	2,40,000
Salary for the purpose of deduction under section 80CCD	14,40,000
Deduction under section 80CCD(1) is restricted to 10% of Rs.14,40,000 (as against actual contribution of Rs.1,80,000, being 15% of basic salary of Rs.12,00,000)	1,44,000
As per section 80CCD(1B), a further deduction of upto Rs. 50,000 is allowable. Therefore, deduction under section 80CCD(1B) is Rs. 36,000 (Rs.1,80,000 - Rs.1,44,000).	36,000

Rs.1,44,000 is allowable as deduction under section 80CCD(1). This would be taken into consideration and be subject to the overall limit of Rs. 1,50,000 under section 80CCE.

Rs. 36,000 allowable as deduction under section 80CCD(1B) is outside the overall limit of Rs.1,50,000 under section 80CCE.

In the alternative, Rs.50,000 can be claimed as deduction under section 80CCD(1B). The balance Rs.1,30,000 (Rs.1,80,000 - Rs.50,000) can be claimed as deduction under section 80CCD(1).

(c) 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 Rs.1,44,000, even though the entire employer's contribution of Rs.1,80,000 is included in salary under section 17(1)(viii). However, this deduction of employer's contribution of Rs.1,44,000 to pension scheme would be outside the overall limit of Rs.1,50,000 under section 80CCE i.e., this deduction would be over and above the other deductions which are subject to the limit of Rs.1,50,000.

Illustration 6

The gross total income of Mr. X for the A.Y.2018-19 is Rs.5,00,000. He has made the following investments/payments during the F.Y.2017-18 –

Particulars		`
(1)	Contribution to PPF	1,10,000

(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	1,05,000

Compute the eligible deduction under Chapter VI-A for the A.Y.2018-19.

Solution

Computation of deduction under Chapter VI-A for the A.Y.2018-19

Particulars		`
Deduction under section 80C		
(1)	Contribution to PPF – fully allowed, since it is within the limit of Rs.1,50,000	1,10,000
(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	25,000
		1,80,000
Restricted to `1,50,000, being the maximum permissible deduction u/s 80C		1,50,000
Deduction under section 80CCC		
(4)	Contribution to approved pension fund of LIC	1,05,000
		2,55,000
As per section 80CCE, the aggregate deduction under section 80C, 80CCC and 80CCD(1) has to be restricted to Rs.1,50,000		
Deduction allowable under Chapter VIA for the A.Y.2018-19		**1,50,000**

Illustration 7

Mr. X, Mr. Y and Mr. Z, new retail investors for the previous year 2015-16, 2016-17 and 2017-18, respectively, have made the following investments in equity shares/units of equity oriented fund of Rajiv Gandhi Equity Savings Scheme for the P.Y.2017-18 as below:

Particulars		*Mr. X*	*Mr. Y*	*Mr. Z*
		`	`	`
(i)	*Investment in listed equity shares*	*20,000*	*45,000*	*32,000*
(ii)	*Investment in units of equity-oriented fund*	*40,000*	-	*18,000*

(iii)	Gross Total Income (comprising of salary income and bank interest)	11,25,000	12,15,000	11,50,000

Mr. X has claimed deduction under section 80CCG for A.Y. 2016-17 and A.Y. 2017-18 and Mr. Y for A.Y. 2017-18.

Compute the deduction under section 80CCG for the Assessment Year 2018-19.

Solution

Computation of Deduction under section 80CCG for the A.Y.2018-19

Particulars	Mr. X	Mr. Y	Mr. Z
	`	`	`
Deduction u/s 80CCG for A.Y. 2018-19	**25,000**	**NIL**	**NIL**
Remark	(Restricted to 50% of Rs.50,000)	(Since GTI > Rs.12,00,000)	No deduction is allowed from A.Y.2018-19.

Note – Mr. X is eligible for deduction under section 80CCG for A.Y. 2018-19, since he has claimed deduction thereunder for A.Y. 2016-17 and A.Y. 2017-18 and he fulfills the conditions for claim of deduction in A.Y. 2018-19.

(6) Deduction in respect of medical insurance premium [Section 80D]

Illustration 8

Mr. A, aged 40 years, paid medical insurance premium of Rs.20,000 during the P.Y.2017-18 to insure his health as well as the health of his spouse. He also paid medical insurance premium of Rs.27,000 during the year to insure the health of his father, aged 63 years, who is not dependant on him. He contributed Rs.3,600 to Central Government Health Scheme during the year. He has incurred Rs.3,000 in cash on preventive health check-up of himself and his spouse and Rs.4,000 by cheque on preventive health check-up of his father. Compute the deduction allowable under section 80D for the A.Y.2018-19.

Solution

Deduction allowable under section 80D for the A.Y.2018-19

	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	20,000	20,000
(ii)	Contribution to CGHS	3,600	3,600
(iii)	Exp. on preventive health check-up of self & spouse	3,000	1,400
		26,600	**25,000**
B.	**Premium paid and medical expenditure incurred for father, who is a senior citizen**		
(i)	Medi-claim premium paid for father, who is over 60 years of age	27,000	27,000
(ii)	Expenditure on preventive health check-up of father	4,000	3,000
		31,000	**30,000**
	Total deduction under section 80D (` 25,000 + ` 30,000)		55,000

Notes:

(1) The total deduction under A.(i), (ii) and (iii) above should not exceed Rs.25,000. Therefore, the expenditure on preventive health check-up for self and spouse would be restricted to Rs.1,400, being (Rs.25,000 – Rs.20,000 – Rs.3,600).

(2) The total deduction under B. (i) and (ii) above should not exceed Rs.30,000. Therefore, the expenditure on preventive health check-up for father would be restricted to Rs.3,000, being (Rs.30,000 – Rs.27,000).

(3) In this case, the total deduction allowed on account of expenditure on preventive health check-up of self, spouse and father is Rs.4,400 (i.e., Rs.1,400 + Rs.3,000), which is less than the maximum permissible limit of Rs.5,000.

Illustration 9

Mr. Y, aged 40 years, paid medical insurance premium of Rs.22,000 during the P.Y.2017-18 to insure his health as well as the health of his spouse and dependant children. He also paid medical insurance premium of Rs.33,000 during the year to insure the health of his father, aged 67 years, who is not dependant on him. He contributed Rs. 2,400 to Central Government Health Scheme

during the year. Compute the deduction allowable under section 80D for the A.Y.2018-19.

Solution

Deduction allowable under section 80D for the A.Y.2018-19

	Particulars	`
(i)	Medical insurance premium paid for self, spouse and dependant children	22,000
(ii)	Contribution to CGHS	2,400
(iii)	Medi-claim premium paid for father, who is over 60 years of age (Rs.33,000 but restricted to Rs.30,000, being the maximum allowable)	30,000
		54,400

Note – The total deduction under (i) and (ii) above should not exceed Rs.25,000. In this case, since the total of (i) and (ii) (i.e., Rs.24,400) does not exceed Rs.25,000, the same is fully allowable under section 80D.

However, had the medical insurance premium paid for self, spouse and children been Rs.24,000 instead of Rs.22,000, then, the total of Rs.26,400 (i.e., Rs.24,000 + Rs.2,400) under (i) and (ii) above would be restricted to Rs.25,000. In such a case, the total deduction allowable under section 80D would be Rs.55,000 [i.e., Rs.25,000 [(i) & (ii)] + Rs.30,000 (iii)].

(7) Deduction in respect of maintenance including medical treatment of a dependant disabled [Section 80DD]

Illustration 10

Mr. X is a resident individual. He deposits a sum of Rs.50,000 with Life Insurance Corporation every year for the maintenance of his handicapped grandfather who is wholly dependant 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. 2018-19.

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 11

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 Rs.75,000 under section 80DD, irrespective of the amount deposited. In case his father has severe disability, the deduction would be Rs.1,25,000.

(8) Deduction in respect of medical treatment etc. [Section 80DDB]

Illustration 12

Mr. B has taken three education loans on April 1, 2017, 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.2018-19.

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 = Rs.20,000 + Rs.10,000 + Rs.18,000 = Rs.48,000.

(10) Deduction for interest on loan borrowed for acquisition of self-occupied house property by an individual [Section 80EE]

Illustration 13

Mr. A purchased a residential house property for self-occupation at a cost of Rs. 45 lakh on 1.4.2017, in respect of which he took a housing loan of Rs.35 lakh from Bank of India@11% p.a. on the same date. The loan was sanctioned on 28th March, 2017. Compute the eligible deduction in respect of interest on housing loan for A.Y.2018-19 under the provisions of the Income-tax Act, 1961, assuming that the entire loan was outstanding as on 31.3.2018 and he does not own any other house property.

Solution

Particulars		`
Interest deduction for A.Y.2018-19		
(i)	**Deduction allowable while computing income under the head "Income from house property"**	
	Deduction under section 24(b) Rs.3,85,000 [Rs.35,00,000 × 11%]	
	Restricted to	2,00,000
(ii)	**Deduction under Chapter VI-A from Gross Total Income**	
	Deduction under section 80EE `1,85,000 (Rs.3,85,000 – Rs.2,00,000) Restricted to	50,000

(11) Deduction in respect of donations to certain funds, charitable institutions etc. [Section 80G]

Illustration 14

Mr. Shiva aged 61 years, has gross total income of Rs.7,75,000 comprising of income from salary and house property. He has made the following payments and investments:

(i) Premium paid to insure the life of her major daughter (policy taken on 1.4.2014) (Assured value Rs.1,80,000) – Rs.20,000.

(ii) Medical Insurance premium for self – Rs.12,000; Spouse – Rs.14,000.

(iii) Donation to a public charitable institution registered under 80G Rs.1,50,000 by way of cheque.

(iv) LIC Pension Fund – Rs.60,000.

(v) Donation to National Children's Fund - Rs.25,000 by way of cheque

(vi) Donation to Jawaharlal Nehru Memorial Fund - Rs.25,000 by way of cheque

(vii) Donation to approved institution for promotion of family planning - Rs.40,000 by way of cheque

Compute the total income of Mr. Shiva for A.Y. 2018-19.

Solution

Computation of Total Income of Mr. Shiva for A.Y. 2018-19

Particulars	`	`
Gross Total Income		**7,75,000**
Less: Deduction under section 80C		
Life insurance premium paid for insurance of major daughter (Maximum 10% of the assured value Rs.1,80,000, as the policy is taken after 31.3.2012)	18,000	
Deduction under section 80CCC in respect of LIC pension fund	60,000	78,000
Deduction under section 80D		
Medical Insurance premium in respect of self and spouse		26,000
		6,71,000
Deduction under section 80G (See Working Note below)		91,050
Total income		**5,79,950**

Working Note: Computation of deduction under section 80G

	Particulars of donation	Amount donated (`)	% of deduction	Deduction u/s 80G (`)
(i)	National Children's Fund	25,000	100%	25,000
(ii)	Jawaharlal Nehru Memorial Fund	25,000	50%	12,500
(iii)	Approved institution for promotion of family planning	40,000	100%, subject to qualifying limit	40,000
(iv)	Public Charitable Trust	1,50,000	50% subject to qualifying limit (See Note below)	13,550
				91,050

Note - Adjusted total income = Gross Total Income – Amount of deductions under section 80C to 80U except section 80G i.e., Rs.6,71,000, in this case.

Rs.67,100, being 10% of adjusted total income is the qualifying limit, in this case.

Firstly, donation of `40,000 to approved institution for family planning qualifying for 100% deduction subject to qualifying limit, has to be adjusted against this amount.

Thereafter, donation to public charitable trust qualifying for 50% deduction, subject to qualifying limit is adjusted.

Hence, the contribution of Rs.1,50,000 to public charitable trust is restricted to Rs. 27,100 (being, Rs.67,100 - Rs.40,000), 50% of which would be the deduction under section 80G. Therefore, the deduction under section 80G in respect of donation to public charitable trust would be `13,550, which is 50% of Rs.27,100.

(12) Deduction in respect of rent paid [Section 80GG]

Illustration 15

Mr. Ganesh, a businessman, whose total income (before allowing deduction under section 80GG) for A.Y.2018-19 is Rs.4,60,000, paid house rent at Rs.12,000 p.m. in respect of residential accommodation occupied by him at Mumbai. Compute the deduction allowable to him under section 80GG for A.Y.2018-19.

Solution

The deduction under section 80GG will be computed as follows:

(i) Actual rent paid less 10% of total income

Rs. 1,44,000 (-) $\frac{(10\% \text{ of } 4,60,000)}{100}$ = Rs.98,000 (A)

(ii) 25% of total income

$$\frac{25 \times 4,60,000}{100} = \text{Rs.}1,15,000 \text{ (B)}$$

(iii) Amount calculated at Rs.5,000 p.m. = Rs.60,000

(C) Deduction allowable (least of A, B and C) =

Rs.60,000

(13) Deduction in respect of donations for scientific research and rural development [Section 80GGA]

Illustration 16

During the P.Y.2017-18, ABC Ltd., an Indian company,

(1) contributed a sum of Rs.2 lakh to an electoral trust; and

(2) incurred expenditure of Rs.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 Rs.2,25,000 under section 80GGB in respect of sum of Rs.2 lakh contributed to an electoral trust and Rs.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 Rs.25,000 would be disallowed while computing business income/gross total income. However, the said expenditure incurred by an Indian company is allowable as a deduction from gross total income under section 80GGB.

(15) Deduction in respect of contributions given by any person to political parties [Section 80GGC]

Illustration 17

A Ltd. was incorporated on 1.4.2017 to carry on the business of innovation, development, deployment and commercialization of new processes driven by technology. It holds a certificate of eligible business from the notified IMBC^2.

Its total turnover and profits and gains from such business for the P.Y.2017-18 to P.Y.2023-24 are as follows:

Particulars	P.Y. 2017-18	P.Y. 2018-19	P.Y. 2019-20	P.Y. 2020-21	P.Y. 2021-22	P.Y. 2022-23	P.Y. 2023-24
	(Rs.in crores)						
Total turnover	15.42	18.36	20.21	22.72	24.95	23.52	24.68
Profits/Losses	(2.52)	(1.37)	6.52	8.13	9.87	7.59	9.42

Is A Ltd. eligible for any tax benefit under the provisions of the Income-tax Act, 1961? If yes, what is the benefit available?

Solution

A Ltd. is an eligible start-up, since –

(1) it is a company engaged in eligible business of innovation, development, deployment and commercialization of new processes driven by technology. It holds a certificate of eligible business from the notified IMBC.

(2) it is incorporated during the period 1.4.2016 to 31.3.2019.

(3) its total turnover does not exceed Rs.25 crores in any previous year from P.Y.2016-17 to P.Y.2020-21.

(4) it holds a certificate of eligible business from the notified IMBC

Therefore, A Ltd., being an eligible start-up, is eligible for deduction under section 80-IAC of 100% of the profits and gains derived by it from an eligible business for any three consecutive assessment years out of seven years beginning from the year in which the eligible start up is incorporated i.e. P.Y.2017-18.

In the first and second year i.e., P.Y.2017-18 and P.Y. 2018-19, A Ltd. has incurred a loss. In the subsequent five years i.e., P.Y. 2019-20, P.Y. 2020-21, P.Y. 2021-22, P.Y. 2022-23 and P.Y. 2023-24, A Ltd. has earned profits from eligible business and can hence, claim 100% of its profits as deduction for any three consecutive assessment years under section 80-IAC from the P.Y.2019-20 to P.Y.2023-24. However, for P.Y.2019-20, the profits eligible for deduction would be the profits after set-off of brought forward losses of P.Y.2017-18 and P.Y. 2018-19.

(4) Deductions in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings, etc. [Section 80-IB]

Illustration 18

Mr. A has commenced the business of manufacture of computers on 1.4.2017. He employed 350 new employees during the P.Y.2017-18, the details of whom are as follows –

	No. of employees	Date of employment	Regular/Casual	Total monthly emoluments per employee (`)
(i)	75	1.4.2017	Regular	24,000
(ii)	125	1.5.2017	Regular	26,000
(iii)	50	1.8.2017	Casual	25,500
(iv)	100	1.9.2017	Regular	24,000

The regular employees participate in recognized provident fund while the casual employees do not. Compute the deduction, if any, available to Mr. A for A.Y.2018-19, if the profits and gains derived from manufacture of computers that year is Rs.75 lakhs and his total turnover is Rs.2.16 crores.

What would be your answer if Mr. A has commenced the business of manufacture of apparel on 1.4.2017?

Solution

Mr. A is eligible for deduction under section 80JJAA since he is subject to tax audit under section 44AB for A.Y.2018-19, as his total turnover from business exceeds Rs.1 crore and he has employed "additional employees" during the P.Y.2017-18.

I **If Mr. A is engaged in the business of manufacture of computers**

Additional employee cost = Rs.24,000 × 12 × 75 **[See Working Note below]** =

Rs.2,16,00,000

Deduction under section 80JJAA = 30% of Rs.2,16,00,000 = Rs.64,80,000.

Working Note:

Number of additional employees

Particulars		No. of workmen	
Total number of employees employed during the year			350
Less:	Casual employees employed on 1.8.2017 who do not participate in recognized provident fund	50	
	Regular employees employed on 1.5.2017, since their total monthly emoluments exceed Rs.25,000	125	
	Regular employees employed on 1.9.2017 since they have been employed for less than 240 days in the P.Y.2017-18.	100	275
Number of "additional employees"			**75**

Note - Since casual employees do not participate in recognized provident fund, they do not qualify as additional employees. Further, 125 regular employees employed on 1.5.2017 also do

not qualify as additional employees since their monthly emoluments exceed Rs.25,000. Also, 100 regular employees employed on 1.9.2017 do not qualify as additional employees for the P.Y.2017-18, since they are employed for less than 240 days in that year.

Therefore, only 75 employees employed on 1.4.2017 qualify as additional employees, and the total emoluments paid or payable to them during the P.Y.2017-18 is deemed to be the additional employee cost.

II **If Mr. A is engaged in the business of manufacture of apparel**

If Mr. A is engaged in the business of manufacture of apparel, then, he would be entitled to deduction under section 80JJAA in respect of employee cost of regular employees employed on 1.9.2017, since they have been employed for more than 150 days in the previous year 2017-18.

Additional employee cost = Rs.2,16,00,000 + Rs.24,000 × 7 × 100 = Rs.3,84,00,000

Deduction under section 80JJAA = 30% of Rs.3,84,00,000 = Rs.1,15,20,000

(10) Deduction in respect of certain income of Offshore Banking Units and International Financial Services Centre [Section 80LA]

Illustration 19

Mr. Gurnam, aged 42 years, has salary income (computed) of Rs.5,50,000 for the previous year ended 31.03.2018. He has earned interest of Rs.14,500 on the saving bank account with State Bank of India during the year. Compute the total income of Mr. Gurnam for the assessment year 2018- 19 from the following particulars:

(i) Life insurance premium paid to Birla Sunlife Insurance in cash amounting to Rs.25,000 for insurance of life of his dependant parents. The insurance policy was taken on 15.07.2014 and the sum assured on life of his dependant parents is Rs.1,25,000.

(ii) Life insurance premium of Rs.25,000 paid for the insurance of life of his major son who is not dependant on him. The sum assured on life of his son is Rs.1,75,000 and the life insurance policy was taken on 30.3.2012.

(iii) Life insurance premium paid by cheque of Rs.22,500 for insurance of his life. The insurance policy was taken on 08.09.2014 and the sum assured is Rs.2,00,000.

(iv) Premium of Rs.22,000 paid by cheque for health insurance of self and his wife.

(v) Rs.1,500 paid in cash for his health check-up and Rs.4,500 paid in cheque for health check-up for his parents, who are senior citizens.

(vi) Paid interest of Rs.6,500 on loan taken from bank for MBA course pursued by his daughter.

(vii) A sum of Rs.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 2018-19

Particulars	`	`	`
Income from salary			5,50,000
Interest on saving bank deposit			14,500
Gross Total Income			**5,64,500**
Less: **Deduction under Chapter VI-A**			
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	20,000	45,000	
Under section 80D (See Note 2)			
Premium paid for health insurance of self and wife by cheque	22,000		
Payment made for health check-up:			
- Self ` 1,500			
- His Parents ` 4,500			
` 6,000 restricted to	5,000	27,000	
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 4)			
Interest on savings bank account ` 14,500 restricted to		10,000	88,500
Total Income			**4,76,000**

Notes:

(1) As per section 80C, no deduction is allowed in respect of premium paid for life insurance of parents whether they are dependant or not. Therefore, no deduction is allowable in respect of Rs.25,000 paid as premium for life insurance of dependant parents of Mr. Gurnam.

In respect of insurance policy issued after 01.04.2012, deduction shall be allowed forlife insurance premium paid only to the extent of 10% of sum assured. 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. 277

Therefore, in the present case, deduction of Rs.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 Rs.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 Rs.2,00,000 since, the policy was issued after 01.04.2012 and the premium amount exceeds 10% of sum assured.

(2) 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, deduction shall be allowed up to Rs.25,000. Further, deduction up to Rs.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-checkup 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 Rs.22,000 is allowed in respect of premium paid for health insurance of self and wife. Also, the aggregate value of premium paid for health insurance and the payment for health check-up is `23,500 (`22,000 + Rs.1,500), which is less than Rs.25,000. Further, deduction up to a maximum of Rs.5,000 is allowable in respect of health check-up of self and his parents. This implies that Rs.3,500 is allowable for health check-up of parents which falls within the additional limit of `30,000 for mediclaim premium and expenditure on preventive health check-up of parents who are senior citizens.

(3) No deduction shall be allowed under section 80G in case the donation is made in cash of a sum exceeding Rs.2,000. Therefore, no deduction is allowed under section 80G in respect of donation made to institution approved therein.

(4) 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 Rs.10,000. Therefore, a deduction of Rs.10,000 is allowable from the gross total income of Mr. Gurnam, though the interest from savings bank account is Rs.14,500.

EXERCISE

Question 1

Mr. Srinivasan, aged 61 years, furnishes the following particulars for the year ending 31.03.2018:

(a) Life Insurance Premium paid – Rs.15,000, actual capital sum of the policy assured for Rs.1,20,000. The insurance policy was taken on 01.04.2011;

(b) Contribution to Public Provident Fund – Rs.40,000 in the name of father;

(c) Tuition fee payment – Rs.8,000 each for 2 sons pursuing full time graduation course in Calcutta; Tuition fee for daughter pursuing PHD in Kellogg University, USA – Rs.2.50 Lacs;

(d) Housing loan principal repayment – Rs.32,000 to Axis Bank. This property is under construction at Calcutta as on 31.03.2018;

(e) Principal repayment of housing loan taken from a relative – Rs.70,000. The property is self-occupied situated at Pune;

(f) Deposit under Senior Citizens Savings Scheme – Rs.15,000;

(g) Five-year deposits in an account under Post Office Time Deposit Scheme – Rs.50,000;

(h) Investment in National Savings Certificate – Rs.70,000;

Compute the deduction eligible under appropriate provisions of section 80C for A.Y. 2018-19.

Answer

Computation of eligible deduction under section 80C for A.Y.2018-19

Particulars	`
Life Insurance Premium **(See Note 1)**	15,000
Contribution to Public Provident fund **(See Note 2)**	Nil
Tuition fee of 2 sons for graduation course **(See Note 3)**	16,000
Housing loan principal repayment **(See Notes 4 & 5)**	Nil
Senior Citizen Savings Scheme deposit **(See Note 6)**	15,000
Post Office Time Deposit Scheme **(See Note 6)**	50,000
Investment in National Savings Certificate	70,000
Total Investment	**1,66,000**
Eligible deduction under section 80C restricted to	1,50,000

Notes:

1. Any amount of life insurance premium paid in excess of the specified percentage of actual capital sum assured shall be ignored for the purpose of deduction under section 80C. In the given case, since the insurance policy has been issued before 1.04.2012, therefore, premium paid upto 20% of actual capital sum assured i.e., Rs.24,000 shall be allowed as deduction. Hence, the premium of
Rs.15,000 paid during the year is allowable as deduction under section 80C.

2. In the case of an individual, contribution to PPF can be made in his name or in the name of his spouse or children to qualify for deduction under section 80C. **As the contribution was made in the name of his father, deduction is not allowable.**

3. Tuition fee paid is eligible for deduction under section 80C for a maximum of two children. Therefore, Rs.16,000 shall be allowed as deduction. **Tuition fee paid to an educational institution situated outside India is not eligible for deduction.**

4. In order to claim the principal repayment on loan borrowed for house property as deduction, the construction of such property should have been completed and should be chargeable to tax under the head "Income from house property". In the given case, since the property is under construction, principal repayment does not qualify for deduction.

5. Repayment of principal on housing loan is not allowed as deduction in case the loan is borrowed from friends, relatives etc. In order to qualify for deduction, the loan should have been

obtained from Central Government / State Government / bank / specified employer / institution.

6. The following investments are also eligible for deduction under section 80C:-

(1) five year time deposit in an account under Post Office Time Deposit Rules, 1981; and

(2) deposit in an account under the Senior Citizens Savings Scheme Rules, 2004.

Question 2

X Ltd. has two units, unit 'N' and unit 'Y'. Unit 'N' engaged in the business of power generation installed a windmill in March, 2017 and had a profit of Rs.100 lakhs in Assessment Year 2017-18. X Ltd. claimed depreciation of Rs.120 lakhs on windmill against the profit of Rs.100 lakhs from power generation business which was eligible for deduction under section 80-IA. Unit 'Y', engaged in manufacturing of wires, non-eligible business, had a profit of Rs.70 lakhs for Assessment Year 2018-19.

The loss of Rs.20 lakhs, i.e., balance depreciation not set off pertaining to unit 'N' was set-off against the profits of unit 'Y' carrying on non-eligible business, by the assessee, X Ltd. The Assessing Officer was of the view that depreciation relating to a business eligible for deduction under section 80-IA cannot be set-off against non-eligible business income. Hence, unabsorbed depreciation should be carried forward to the subsequent year to be set off against eligible business income of the assessee of that year.

Give your views on the correctness of the action of the Assessing Officer.

Answer

In CIT v. Swarnagiri Wire Insulations Pvt. Ltd. (2012) 349 ITR 245, the Karnataka High Court observed that it is a generally accepted principle that the deeming provision of a particular section cannot be breathed into another section. Therefore, the deeming provision contained in section 80-IA(5) cannot override the provisions of section 70(1).

In this case, X Ltd. had incurred loss in eligible business (power generation) on account of claiming depreciation of Rs.120 lacs. Hence, section 80-IA becomes insignificant, since there is no profit from which this deduction can be claimed.

It is, thereafter, that section 70(1) comes into play, whereby an assessee is entitled to set off the losses from one source against income from another source under the same head of income. Accordingly, X Ltd. is entitled to the benefit of set off of loss of Rs.20 lacs (representing balance depreciation not set-off) pertaining to Unit N engaged in eligible business of power generation against profit of Rs.70 lacs of Unit Y carrying on non-eligible business. Therefore, the net profit of
Rs.50 lacs would be taxable in the A.Y.2018-19.

However, once set-off is allowed under section 70(1) against income from another source under the same head, a deduction to such extent is not possible in any subsequent assessment year i.e., the loss (arising on account of balance depreciation of eligible business) so set-off under section 70(1) has to be first deducted while computing profits eligible for deduction under section 80-IA in the subsequent year. Accordingly, in the A.Y.2019-20, the net profits of Unit N has to be reduced by Rs.20 lacs for computing the profits eligible for deduction under section 80-IA in that year.

The action of the Assessing Officer in not permitting set-off of loss of eligible business against profits of non-eligible business in this case is, therefore, not correct.

Question 3

From the following details, compute the total income of Mr. A, Mr. B and Mr. C for A.Y.2018-19 –

	Particulars	Mr. A	Mr. B	Mr. C
		`	`	`
(i)	Salary (computed)	9,25,000	10,45,000	11,15,000
(ii)	Interest income (on fixed deposits)	75,000	85,000	95,000

The particulars of their other investments/payments made during the P.Y.2017-18 are given hereunder –

	Particulars	`
(1)	*Deposit in Public Provident Fund (PPF) by Mr. A*	*1,50,000*
(2)	*Life insurance premium paid by Mr. C, the details of which are as follows -*	

	Date of issue of policy	Person insured	Actual capital sum assured (`)	Insurance premium paid during 2017-18 (`)
(i)	14/5/2011	Self	1,25,000	15,000
(ii)	11/6/2012	Spouse	1,25,000	15,000
(iii)	31/7/2013	Handicapped Son (section 80U disability)	2,00,000	32,000

Payment of medical insurance premium by the following persons to insure their health:

Payer	Amount in `	Mode of payment
Mr. A (aged 55 years)	30,000	Account payee cheque
Mr. B (aged 52 years)	15,000	Cash
Mr. C (aged 48 years)	20,000	Crossed cheque

Mr. B paid interest on loan taken for the purchase of house in which he currently resides. He is claiming benefit of self-occupation under section 23(2) in respect of this house. He does not own any other house.	*2,20,000*
Repayment of principal amount of loan taken for purchase of the said house	*1,70,000*
Contribution by Mr. A by cheque to National Children's Fund during the year.	*30,000*
Mr. B makes the following donations during the P.Y.2017-18 -	
Donation to BJP by crossed cheque	*50,000*

Answer

Computation of total income for A.Y.2018-19

	Particulars	Mr. A	Mr. B	Mr. C
		`	`	`
	Salary	9,25,000	10,45,000	11,15,000
	Income from house property **[See Note 4]**		(2,00,000)	
	Income from other sources (Interest)	75,000	85,000	95,000
(A)	**Gross total income**	**10,00,000**	**9,30,000**	**12,10,000**
	Less: Deductions under Chapter VIA			
	Under section 80C			
	Deposit in PPF (restricted to maximum Rs.1,50,000) **[See Note 3]**	1,50,000		
	LIC premium paid **[See Note 1]**			57,500
	Principal repayment of housing loan (restricted to Rs.1,50,000) **[See Note 4]**		1,50,000	
	Under section 80D			
	Medical insurance premium **[See Note 2]**	25,000	Nil	20,000
	Under section 80G			
	Contribution to National Children's Fund **[See Note 5]**	30,000		
	Under section 80GGC [See Note 6]			
	Donation to BJP by crossed cheque		50,000	
	Cash donation to Electoral Trust		Nil	
(B)	**Total deduction under Chapter VIA**	**2,05,000**	**2,00,000**	**77,500**
(C)	**Total Income (A) – (B)**	**7,95,000**	**7,30,000**	**11,32,500**

Notes:

(1) Deduction u/s 80C in respect of life insurance premium paid by Mr. C

Date of issue of policy	Person insured	Actual capital sum assured	Insurance premium paid during 2017-18	Restricted to % of sum assured	Deduction u/s 80C
14/5/2011	Self	1,25,000	15,000	20%	15,000
11/6/2012	Spouse	1,25,000	15,000	10%	12,500
31/7/2013	Handicapped Son (section 80U disability)	2,00,000	32,000	15%	30,000
			Total		**57,500**

(2) Medical Insurance Premium

(i) Medical insurance premium of ` 30,000 paid by account payee cheque by Mr. A is allowed as a deduction under section 80D, subject to a maximum of ` 25,000.

(ii) Medical insurance premium paid by cash is not allowable as deduction. Hence, Mr. B is not eligible for deduction under section 80D in respect of medical insurance premium of ` 15,000 paid in cash.

(iii) Mr. C is eligible for deduction of ` 20,000 under section 80D in respect of medical insurance premium paid by crossed cheque.

(3) The maximum amount eligible for deduction under section 80C shall not exceed ` 1,50,000. Further, the investment limit in PPF also increased to ` 1,50,000. Since Mr. A has no other investment under section 80C during the P.Y. 2017-18, Mr. A would be eligible for deduction of ` 1,50,000 in respect of PPF.

(4) Deduction in respect of interest and principal repayment of housing loan

Mr. B is eligible for a maximum deduction of ` 2,00,000 under section 24 in respect of interest on housing loan taken in respect of a self-occupied property, for which he is claiming benefit of "Nil" annual value. Therefore, ` 2,00,000 would represent his loss from house property.

Further, the maximum amount eligible for deduction under section 80C should not exceed ` 1,50,000. Since, Mr. B has no other investment under section 80C during the previous year 2017-18, he would be eligible for deduction of ` 1,50,000 in respect of principal repayment of housing loan.

(5) Contribution to National Children's Fund qualifies for 100% deduction under section 80G. Therefore, Mr. A is entitled to 100% deduction of the sum of ` 30,000 contributed by him by way of cheque to National Children's Fund.

(6) Mr. B is eligible for deduction under section 80GGC in respect of donation to a political party made otherwise than by way of cash. However, cash donations to electoral trust do not qualify for deduction under section 80GGC.

Question 4

Following issues have been raised by Navi Limited in connection with its eligibility for claiming deduction under section 80-IB for your consideration and advice for the assessment year 2018-19:

(i) It operates two separate industrial units. One unit is eligible for deduction under section 80-IB, while the other unit is not eligible for such deduction. If the eligible unit has profit and the other unit has loss, should it claim deduction after setting off the loss of the other unit against profit of the eligible unit?

(ii) Its profit from one unit includes sale of import entitlement, duty drawback and interest from customers for delayed payment. Is it permissible to claim deduction on these items of income?

Answer

(i) Section 80-IB(13) provides that the provisions contained in section 80-IA(5) shall, so far as may be, apply to the eligible business under section 80-IB. Accordingly, for the purpose of computing the deduction under section 80-IB, the profits and gains of an eligible business shall be computed as if such eligible business was the only source of income of the assessee.

Therefore, Navi Limited should claim deduction under section 80-IB on profit from the eligible unit without setting off loss suffered in the other unit. It may be noted that the aggregate deduction under Chapter VI-A, however, cannot exceed the gross total income of the assessee.

(ii) Under section 80-IB, where the gross total income of an assessee includes any profits and gains derived from an industrial undertaking referred to in the section, there shall be allowed, in computing the total income of the assessee, a deduction from such profits and gains at the specified percentage and for such number of years as specified in the section. In CIT vs. Sterling Foods (1999) 237 ITR 579 (SC) and Liberty India vs. CIT (2009) 317 ITR 218 (SC), it was held that sale of import entitlement and duty drawback cannot be construed as income derived from industrial undertaking. Therefore, such income cannot be included in computing income for the purpose of deduction under section 80-IB.

Interest income derived by an undertaking on delayed collection of sale proceeds shall be treated as income derived from the industrial undertaking, and therefore, the same would be eligible for deduction under section 80-IB. [Phatela Cotgin Industries Private Limited vs CIT (2008) 303 ITR 411 (P & H)].

Question 5

PQR Co-operative Bank, a co-operative society, having its area of operation confined to Gubbi Taluk and the principal object of which is to provide for long-term credit for agricultural and rural development activities, has received the following amounts during the year ending 31.3.2018:

(i) Interest amounting to Rs.1,00,000 from its members on loans advanced to them.

(ii) Interest amounting to Rs.1,50,000 on deposits with other co-operative societies.

(iii) Rent amounting to Rs.2,00,000 from letting out its godowns for storage of commodities.

PQR Co-operative Bank seeks your advice in the matter of taxability of the above amounts and the

eligibility for deduction, if any, in respect thereof for the assessment year 2018-19.

Answer

Sub-clause (viia) to section 2(24) includes within the scope of definition of income, the profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members. Hence, the interest of Rs.1,00,000 received by PQR Co-operative Bank on loans advanced to its members constitutes its income.

Further, interest received amounting to Rs.1,50,000 on deposits with other co-operative societies and rent amounting to Rs.2,00,000 received from letting out its godowns for storage of commodities also constitute the income of the co-operative bank.

Sub-section (4) of section 80P provides that section 80P shall not apply to any co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank.

Explanation to section 80P(4) defines a primary co-operative agricultural and rural development bank to mean a society 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.

PQR Co-operative Bank is a primary co-operative agricultural and rural development bank as defined in the said Explanation since it is a co-operative society having its area of operation confined to Gubbi Taluk and its principal object is to provide long-term credit for agricultural and rural development activities. Therefore, it is eligible for deduction under section 80P.

Interest of Rs.1,00,000 received by the bank on loans advanced to its members is eligible for deduction in full under section 80P(2)(a)(i).

Interest of Rs.1,50,000 received by the bank from deposits with other co-operative societies qualifies for deduction in full under section 80P(2)(d).

Rent of Rs.2,00,000 received by the bank from letting out its godowns for storage of commodities is eligible for deduction in full under section 80P(2)(e).

SIGNIFICANT SELECT CASES

1. Can the Commissioner reject an application for grant of approval under section 80G(5) on the ground that the trust has failed to apply 85% of its income for charitable purposes?

CIT v. Shree Govindbhai Jethalal Nathavani Charitable Trust (2015) 373 ITR 619 (Guj)

Facts of the case: The assessee trust filed an application in Form 10G for grant of approval under section 80G(5)[4]. It also filed copies of trust deed and registration certificate dated 18th August, 2011 with the approving authority. As per the trust deed, the main objects of the trust are educational, social activities, etc. In order to verify the facts stated in the application, the trust was asked to produce books of account, relevant vouchers, donation book and minutes in original. On perusal of the books for financial year 2011-12, it was found that the trust had not applied 85% of its income and therefore, the Commissioner rejected the application of the assessee seeking approval under section 80G(5) and Rule 11AA of the Income-tax Rules, 1962.

Tribunal's view: On appeal, the Tribunal noted the decision of Punjab and Haryana High Court

in the case of CIT v. O.P. Jindal Global University (2013) 38 Taxmann 366, in which it was held that at the time of granting approval of exemption under section 80G, only the objects of the trust are required to be examined and the aspect of application of funds can be examined by the Assessing Officer at the time of framing the assessment. Consequently, the Tribunal held that the Commissioner has erred in refusing to grant recognition to the trust under section 80G(5).

High Court's Observations: The High Court was of the view that the issue in the present case is now not res integra in view of the decision of the Division Bench of this Court in the case of N.N. Desai Charitable Trust v. CIT (2000) 246 ITR 452 (Guj). In that case, the Division Bench observed that, while considering the application for the purpose of section 80G, the authority cannot act as an assessing authority and the enquiry should be confined to finding out if the institution satisfies the prescribed conditions. The Division Bench also made the following observations:

(i) Section 80G does not relate to assessment of the trust or the institution whose income is not liable to be included in the computation of taxable income under various provisions of the Act. Primarily, section 80G is related to giving deduction in respect of donations made by a person to such trusts and institutions.

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[4] Section 80G(5)(i) provides that donation to any institution or fund would qualify for deduction thereunder only if it is established in India for a charitable purpose and derives such income which would not be liable to inclusion in its total income under the provisions of sections 11 and 12 or section 10(23AA)/(23C).

(ii) There are two distinct concepts. The first is whether an institution or fund is such whose income is not liable to be included in the computation of total income, has to be determined on the basis of its status or character. The second is the actual assessment of income, which necessarily takes place in future after donation is received by the donee, on fulfilment of other conditions about application of income by the eligible trusts, which in the very nature of things can operate only after receipt of income. The two are different concepts.

(iii) The liability to assessment is neither affected on account of grant of recognition under section 80G nor on whether the donor ultimately gets deduction in respect of such donation. Once a trust is registered under section 12AA, its income from property includes donation which is covered by section 11(1)(d) or under section 12. Such donations are deemed to be income from property, which are not to be included in the total income under section 11 or section 12. The enquiry under section 80G, hence, cannot go beyond that.

(iv) The scope of enquiry cannot include an enquiry as to whether, at the close of the previous year, the donee-trust will actually be able to apply 85% of its income because non-fulfillment of some conditions by the donee-trust as regards application or accumulation cannot be ascertained in praesenti, when the donation is made. The question of whether the trust will be able to apply 85% of its income can be determined only from the facts existing at the close of the assessment year.

(v) The High Court also noted that similar views were expressed by the Punjab and Haryana High Court in the case of CIT v. O. P. Jindal Global University (2013) 38 Taxmann.com 366.

High Court's Decision: The High Court, thus, concurred with the decision of the Tribunal setting aside the order passed by the Commissioner refusing to grant registration under section 80G(5) to the assessee-trust due to the reason that it has not applied 85% of its income for charitable purposes.

2. Can unabsorbed depreciation of a business of an industrial undertaking eligible for deduction under section 80-IA be set off against income of another non-eligible business of the assessee?

CIT v. Swarnagiri Wire Insulations Pvt. Ltd. (2012) 349 ITR 245 (Kar.)

Facts of the case: The assessee was in the business of manufacture of wires. It installed a windmill for power generation. The assessee claimed depreciation on windmill against income from power generation, which was eligible for deduction under section 80-IA. The balance depreciation was set off against the profits from manufacturing of wires, being a non-eligible business.

Assessing Officer's contention: The Assessing Officer contended that depreciation relating to a business eligible for deduction under section 80-IA cannot be set off against non-eligible business income. Therefore, unabsorbed depreciation was to be carried forward to the subsequent year to be set off against the eligible business income of the assessee of that year.

Tribunal's Observations: The Tribunal observed that the balance depreciation of the eligible business is required to be carried forward for set-off against eligible business income of the next year while determining the profits eligible for deduction under section 80-IA in that year. However, the Tribunal noted that section 80-IA is a beneficial section permitting certain deduction in respect of certain income under Chapter VI-A. A provision granting tax incentive for economic growth should be construed liberally and any restriction placed should also be construed in a reasonable and purposive manner to advance the objects of the provision.

High Court's Observations and Decision: The High Court observed that it is a generally accepted principle that deeming provision of a particular section cannot be breathed into another section. Therefore, the deeming provision contained in section 80-IA(5) cannot override the provisions of section 70(1). The assessee had incurred loss in eligible business after claiming depreciation. Hence, section 80-IA becomes insignificant, since there is no profit from which this deduction can be claimed. It is thereafter that section 70(1) comes into play, whereby the assessee is entitled to set off the losses from one source against income from another source under the same head of income. The Court, therefore, held that the assessee was entitled to the benefit of set off of loss of eligible business against the profits of non-eligible business. However, once set-off is allowed under section 70(1) against income from another source under the same head, a deduction to such extent is not possible in any subsequent assessment year i.e., the loss (arising on account of balance depreciation of eligible business) so set-off under section 70(1) has to be first deducted while computing profits eligible for deduction under section 80-IA in the subsequent year.

***Note** – The crux of the above decision can be explained with a simple example. Let us consider a company, X Ltd., having two units, Unit A and Unit B. If Unit A engaged in eligible business (say, power generation) has a profit of ` 100 lacs in A.Y.2018-19, before claiming depreciation of ` 120 lacs and Unit B engaged in non-eligible business (say, manufacture of wires) has a profit of ` 70 lacs, then, as per the above decision, the loss of ` 20 lacs (representing balance depreciation not set-off) pertaining to Unit A can be set-off against profit of ` 70 lacs of Unit B carrying on non-eligible business. Therefore, the net profit of ` 50 lacs would be taxable in the A.Y.2018-19. If in the next year, i.e. A.Y.2019-20, the net profits of Unit A and Unit B are ` 200 lacs and ` 80 lacs, respectively, then the eligible deduction under section 80-IA for that year would be ` 180 lacs (i.e., ` 200 lacs minus ` 20 lacs, being loss (representing balance depreciation) set-off in the A.Y.2018-19 against other income).*

3. Can transport subsidy, interest subsidy and power subsidy received from the Government be treated as profits "derived from" business or undertaking to qualify for deduction under section 80-IB?

CIT v. Meghalaya Steels Ltd (2016) 383 ITR 217 (SC)

Facts of the case: The assessee-company, engaged in the business of manufacture of steel and ferro silicon, claimed deduction under section 80-IB on the profits and gains of the business/undertaking which included transport subsidy, interest subsidy and power subsidy received from Government.

Revenue's Contentions: The Assessing Officer was of the view that these subsidies were not eligible for deduction under section 80-IB(4) and hence, disallowed the same, contending that the source of the subsidies was the Government and not the business of the assessee, these subsidies have a close and direct nexus with the grants of the Government and not the business of the assessee. Hence, these subsidies, included in the profits, were "attributable to the business" but not "derived from" business to qualify for deduction under section 80-IB. The Commissioner (Appeals) upheld the view of the Assessing Officer. However, the Appellate Tribunal and High Court allowed the deduction in respect of such subsidies.

Supreme Court's Observations: The Supreme Court observed that an important test to determine whether the profits and gains are "derived from" business or an undertaking is that there should be a direct nexus between such profits and gains and the undertaking or business. Such nexus should not be only incidental. As long as profits and gains emanate directly from the business itself, the fact that the immediate source of the subsidies is the Government would make no difference. The profits and gains referred to in section 80-IB has reference to net profit, which can be calculated by deducting from the sale price of an article, all elements of cost which go into manufacturing or selling it. Thus, the profits arrived at after deducting manufacturing costs and selling costs reimbursed to the assessee by the Government, is the profits and gains "derived from" the business of the assessee.

The Supreme Court observed that section 28(iii)(b) specifically states that income from cash assistance, by whatever name called, received or receivable by any person against exports under any scheme of the Government of India, will be income chargeable to income-tax under the head "Profits and gains of business or profession". The Apex Court further observed that if cash assistance received or receivable against exports schemes are being included as income under the head "Profits and gains of business or profession", subsidies which go towards reimbursement of cost of production of goods of a particular business would also have to be included under the head "Profits and gains of business or profession", and not under the head "Income from other sources".

Supreme Court's Decision: The Supreme Court, accordingly, held that transport subsidy, interest subsidy and power subsidy from Government were revenue receipts which were

reimbursed to the assessee for elements of cost relating to manufacture or sale of their products.

Therefore, there is a direct nexus between profits and gains of the undertaking or business, and reimbursement of such subsidies. The subsidies were only in order to reimburse, wholly or partially, costs actually incurred by the assessee in the manufacturing and selling of its products. Accordingly, these subsidies qualify for deduction under section 80-IB.

4. Can Duty Drawback be treated as profit derived from the business of the industrial undertaking to be eligible for deduction under section 80-IB?

CIT v. Orchev Pharma P. Ltd. (2013) 354 ITR 227 (SC)

Supreme Court's Decision: On this issue, the Supreme Court, following the decision in case of *Liberty India v. CIT (2009) 317 ITR 218 (SC)* held that Duty Drawback receipts cannot be said to be profits derived from the business of industrial undertaking for the purpose of computation of deduction under section 80-IB.

Note - *In the case of Liberty India v. CIT (2009) 317 ITR 218 (SC), the Supreme Court observed that DEPB / Duty drawback are incentives which flow from the schemes framed by the Central Government or from section 75 of the Customs Act, 1962. Section 80-IB provides for the allowing of deduction in respect of profits and gains derived from eligible business.* ***However, incentive profits are not profits derived from eligible business under section 80-IB. They belong to the category of ancillary profits of such undertaking.*** *Profits derived by way of incentives such as DEPB/Duty drawback cannot be credited against the cost of manufacture of goods debited in the profit and loss account and they do not fall within the expression "profits derived from industrial undertaking" under section 80-IB. Hence, Duty drawback receipts and DEPB benefits do not form part of the profits derived from the eligible business for the purpose of the deduction under section 80-IB.*

5. Does the period of exemption under section 80-IB commence from the year of trial production or year of commercial production? Would it make a difference if sale was effected from out of the trial production?

CIT v. Nestor Pharmaceuticals Ltd. / Sidwal Refrigerations Ind Ltd. v. DCIT (2010) 322 ITR 631 (Delhi)

Facts of the case: In this case, the assessee had started trial production in March 1998 whereas commercial production started only in April, 1998. Therefore, the assessee claimed deduction under section 80-IB for the assessment years 1999-2000 to 2003-04, whereas the Assessing Officer denied deduction for A.Y.2003-04 on the ground that the five year period would be reckoned from A.Y.1998-99, since the trial production began in March, 1998.

Tribunal's Observations: The Tribunal observed that not only the trial production had started in March 1998 but there was in fact sale of one water cooler and air-conditioner in the month of March 1998. The explanation of the assessee was that this was done to file the registration under the Excise Act and Sales-tax Act.

High Court's Observations & Decision: The High Court observed that with mere trial production, the manufacture for the purpose of marketing the goods had not started which starts only with commercial production, namely, when the final product to the satisfaction of the manufacturer has been brought into existence and is fit for marketing. However, in this case, since the assessee had effected sale in March 1998, it had crossed the stage of trial production and the final saleable product had been manufactured and sold. The quantum of commercial sale and the purpose of sale (namely, to obtain registration of excise / sales-tax) is not material. With the sale of those articles, marketable quality was established. Therefore, the conditions stipulated in section 80-IB were fulfilled with the commercial sale of the two items in that assessment year, and hence the five year period has to be reckoned from A.Y.1998-99.

Note *– Though this decision was in relation to deduction under section 80-IA, as it stood prior to its substitution by the Finance Act, 1999 w.e.f. 1.4.2000, presently, it is relevant in the context of section 80-IB.*

6. Can an assessee who has not claimed deduction under section 80-IB in the initial years, start claiming deduction thereunder for the remaining years during the period of eligibility, if the conditions are satisfied?

Praveen Soni v. CIT (2011) 333 ITR 324 (Delhi)

High Court's Decision: On the above issue, the Delhi High Court held that the provisions of section 80-IB nowhere stipulated a condition that the claim for deduction under this section had to be made from the first year of qualification of deduction failing which the claim will not be allowed in the remaining years of eligibility. Therefore, the deduction under section 80-IB should be allowed to the assessee for the remaining years up to the period for which his entitlement would accrue, provided the conditions mentioned under section 80-IB are fulfilled.

Accordingly, the CBDT has vide this circular, clarified these issues by way of the following FAQs:

Question 1: The profit for the period may include Marked to market (MTM) gains/ losses on account of fair value adjustments on various financial instruments recognised through profit or loss (FVTPL). A situation may arise where the losses on account of fair value adjustments could be added back in view of clause (i) of Explanation 1 to section 115JB(2) of the Act. Whether the losses on such instruments require any adjustment for computing book p rofits for the purposes of MAT?

Answer: Since MTM gains recognised through profit or loss on FVTPL classifi ed financial instruments are included in book profits for MAT computation, it is clarified that MTM losses on such instruments recognised through profit or loss shall not require any adjustments as provided under clause (i) of Explanation 1 to section 115J B(2) of the Act. However, in case of provision for diminution/ impairment in value of assets other than FVTPL financial instruments, the existing adjustment of clause (i) of Explanation 1 to section 115JB (2) of the Act shall apply.

It is further clarified that for financial instruments where gains and losses are recognised through Other Comprehensive income (OCI), the amended provisions of MAT shall continue to apply.

Question 2: For the purposes of section 115JB of the Act, what shall be the starting poin t for computing Book profits for Ind AS compliant companies? Whether Profit before other comprehensive income [Item number XIII in Part 2 (Statement of Profit and Loss) of Division II of Schedule III to the Companies Act 2013] or Total Comprehensive Income (including other comprehensive income) [Item number XV in Part 2 (Statement of Profit and Loss) of Division II of Schedule III to the Companies Act 2013] shall be the starting point?

Answer: Starting point for computing Book profits for Ind AS compliant companies shall be Profit before other comprehensive income [Item number XIII in Part 2 (Statement of Profit and Loss) of Division II of Schedule III to the Companies Act 2013].

Question 3: As per Explanation to Section 115JB(2C) of the Act, the convergence date is defined as the first day of the first Indian Accounting standards reporting period as defined in Ind AS 101. The Memorandum explaining the provisions of the Finance Bill 2017 mentions that the adjustment as on the last day of the comparative period is to be considered. It may be clarified as to what would be the appropriate manner for computation of transition amount on convergence date, 1st April i.e. at the start of the day or at the end of the day?

Answer: In the first year of adoption of Ind AS, the companies would prepare Ind AS financial statement for reporting year with a comparative financial statement for immediately preceding year. As per Ind AS 101, a company would make all Ind AS adjustments on the opening date of the comparative financial year. The entity is also required to present an equity reconciliation between previous Indian GAAP and Ind AS amounts, both on the opening date of preceding year as well as on the closing date of the preceding year. The amounts as on star t of the opening date of the first year of adoption should be considered for the purposes of computation of transition amount.

For example, companies which adopt Ind AS with effect from 1st day of April 2016 are required to prepare their financial statements for the year 2016-17 as per requirements of Ind AS. Such companies are also required to prepare an opening balance sheet as of 1st day of April 2015 and restate the financial statements for the comparative period 2015 -16. In such a case, the first time adoption adjustments as of 31st day of March 2016 should be considered [i.e. the

start of business on 1st day of April 2016 (or, equivalently, close of business on 31st day of March 2016)] for computation of MAT liability for previous year 2016-17 (Assessment year 2017-18) and thereafter.

Question 4: As per Indian GAAP, proposed dividend was required to be recognized in the financial statements for the year for which it pertained to even though these were declared in the subsequent year. Section 115JB of the Act already provides for adjustments for dividend for computation of book profit. As per Ind AS, the amount of proposed dividend (including dividend distribution taxes) is required to be recognized in the year in which it has been declared rather than the year for which it pertains to. Accordingly, on transition to Ind AS, the amount of proposed dividend for FY 2015-16 which was recognized in profit and loss account in FY 2015-16 is required to be reversed and credited to Retained Earnings. For the computation of MAT, whether these balances would form part of the transition amount and thus be adjusted over a period of 5 years?

Answer: Adjustment of proposed dividend (including dividend distribution taxes) shall not form part of the transition amount.

Question 5: Under Ind AS, adjustments on the transition date may have a corresponding impact on deferred taxes. Should the deferred taxes on such amounts be considered for the purpose of transition amount?

Answer: Any deferred taxes adjustments recorded on the transition date shall be ignored for the purpose of computing Transition Amount.

Question 6: As mentioned in Question No.1, clause (i) of Explanation 1 to Section 115JB(2) of the Act provides for adjustments for computation of book profit for the amount or amounts set aside as provision for diminution in the value of any asset. Convergence date adjustments may include adjustment for Provision for Bad and Doubtful Debts (Expected Credit Loss adjustment) at the time of transition. Whether these adjustments would form part of the transition amount referred to in section 115JB(2C) of the Act?

Answer: Adjustments relating to provision for diminution in the value of any assets other than the ones mentioned in Question Number 1 above, shall not be considered for the purpose of computation of the Transition Amount. Therefore, adjustments relating to provision for doubtful debts shall not be considered for the purpose of computation of the transition amount.

Question 7: Under Section 115JB of the Act, transition amount has been defined as the amount or the aggregate of the amounts adjusted in the 'Other Equity' (excluding capital reserve and securities premium reserve) on the convergence date. Whether changes in share appl ication money on reclassification to 'Other Equity' would form part of the Transition Amount?

Answer: Share application money pending allotment which is reclassified to Other Equity on transition date shall not be considered for the purpose of computing Transition Amount.

Question 8: Under Ind AS, Investments in preference share is considered to be a liability and the corresponding dividend expense is debited to Profit and loss account as interest cost. Should such interest expenses on preference shares be deducted for the purpose of MAT computation?

Answer: For the purpose of computation of MAT, profit/Transition Amount shall be increased by dividend/interest on preference share (including dividend distribution taxes) whether presented as dividend or interest.

Question 9: How do we account for items such as equity component, if any, of financial instruments like Non-Convertible debentures (NCDs), Interest free loan etc. included in other equity as per Ind AS for the computation of transition amount under MAT?

Answer: Items such as equity component of financial instruments like NCD's, Interest free loan etc. would be included in the Transition Amount.

Question 10: Where revaluation/fair value adjustments have been made to items of Property, Plant & Equipment (PPE) under Ind AS, as per section 115JB of the Act, the book profit of the previous year in which the items of PPE are retired, disposed or realised shall be increased or decreased, as the case may be, by the revaluation amount relatable to such items of PPE. Whether the revaluation amount to be considered for adjustment should be the gross amount of the revaluation or the amount after adjustment of the deprecia tion on the revaluation amount?

Answer: The book profit of the previous year in which the items of PPE are retired, disposed, realised or otherwise transferred shall be increased or decrease d, as the case may be, by the revaluation amount after adjustment of the depreciation on the revaluation amount relatable to such asset. This has been explained by an illustration as under:

Particulars	Erstwhile Indian GAAP	Ind-AS (considering fair value/revaluation adjustment on PPE)	Fair Value/Revaluation Adjustments and corresponding depreciation
WDV/Deemed Cost as on 1 April 2015	100	1000	900
Depreciation @10% for F.Y. 2015- 16	10	100	90
WDV as on 1 April 2016	90	900	810
Depreciation @10% for F.Y. 2016- 17	9	90	81
WDV as on 1 April 2017	81	810	729*
Sale value as on 1 April 2017	900	900	
Profit on sale credited to P & L	819	90	
Adjustment for MAT - revaluation amount after adjustment of the depreciation	0	729*	

Profit on sale to be considered for MAT	**819**	**819**	

Question 11: How should adjustments for service concession arrangements be treated for the purpose of computation of book profit under MAT?

Answer: Adjustments on account of Service Concession arrangements would be included in the Transition Amount and also on an ongoing basis.

Question 12: Existing clause (iii) of explanation to section 115JB(2) of the Act provides for deduction of lower of the amount of loss brought forward or unabsorbed depreciation as per books of account for computation of book profits. In case where, on adjustment of transition amount, the losses as per books of account gets wiped off, whether deduction for the said amount would be available for assessment year 2017-2018 onwards?

Answer: For assessment year 2017-2018, the deduction of lower of depreciation or losses shall be allowed based on the position as on 31 March 2016. For the subsequent periods, the position as per books of account drawn as per Ind AS shall be considered for computing lower of loss brought forward or unabsorbed depreciation.

Question 13: How Capital Reserves or Securities Premium existing as per old Indian GAAP reclassified to Retained Earnings/ Other Reserves on Convergence date be treated for MAT purpose.

Answer: The Capital Reserves or Securities Premium existing as on the convergence date as per the erstwhile Indian GAAP which are reclassified to Retained Earnings/ Other Reserves under Ind AS and vice versa, shall not be considered for the purposes of Transition Amount.

It is further clarified, that even after such reclassifications, the amount of revaluation reserve shall continue to be considered as revaluation reserve for the purposes of computation of book profit and shall also include transfer to any other reserves by whate ver name called or capitalised.

Question 14: Companies which follow accounting year other than March, 2017 ending for Companies Act purposes and are required to transition to Ind AS will have to prepare financial statements for MAT purposes for FY 2016-17 partly under Indian GAAP and partly under Ind AS. How should such companies compute MAT on transition to Ind AS?

Answer: In view of second proviso to section 115JB (2) of the Act, companies will be required to follow Indian GAAP for the pre-convergence period and Ind AS for the balance period.

For example, a Company following December ending will be required to prepare, accounts for MAT purposes under Indian GAAP for 9 months upto December 2016 and under Ind AS for 3 months thereafter. The transition amount will be calculated with reference to 1st January, 2017.

Illustration 1

A domestic company, ABC Ltd., furnishes the following particulars in respect of Assessment Year 2018-19 and seeks your opinion on the application of section 115JB. You are also required to compute the total income and tax payable.

(1) Profits as per Statement of profit and loss account as per the Companies Act, 2013 Rs.215 Lacs

(2) Statement of Profit and Loss A/c includes: 296

(a) Credits: Dividend income from Indian companies Rs.20 Lacs

Excess realized on sale of land held as investment Rs.30 Lacs

(b) Debits: Depreciation on straight line method basis Rs.100 Lacs

Provision for loss of subsidiary company Rs.60 Lacs

(3) Depreciation allowable as per the Income-tax Rules, 1962 Rs.150 Lacs

(4) Short term Capital gains on sale of land mentioned above as computed under Income-tax Act, 1961 Rs.40 Lacs

(5) Losses brought forward as per books of account and as per Income -tax Act, 1961:

Business loss Rs.50 Lacs

Unabsorbed depreciation Rs.60 Lacs

The company has represented to you that the excess realized on sale of land cannot form part of the book profit for purposes of section 115JB. You will have to deal with this issue assuming that ABC Ltd. is not required to comply with the Indian Accounting Standards.

Note - The turnover of ABC Ltd. for the P.Y.2015-16 was Rs.40 crore.

Solution

In the case of a company, it has been provided that where tax on 18.50% of book profit exceeds tax on total income computed as per normal provisions, the book profit shall be deemed to be the total income for tax purposes.

It is therefore necessary to compute total income as per Income-tax Act, 1961 as well as book profits.

I. Computation of Total income as per the Income-tax Act, 1961

Particulars	Rs.(in Lacs)	
Net profit as per statement of profit and loss account		215
Add: Depreciation debited to profit and loss account	100	
Provision for losses of subsidiary company	60	160
		375
Less: Dividend income – exempt under section 10(34)	20	
Excess realized on sale of land (considered separately)	30	
Depreciation allowable as per Income-tax Rules, 1962	150	200
Business Income		175
Less: Set-off of brought forward business loss		50
		125
Capital gains		40
		165
Less: Set-off of unabsorbed depreciation		60
Total Income as per Income-tax Act, 1961		**105**

II. Computation of book profit under section 115JB

Particulars		(Rs.in Lacs)
Net profit as per profit and loss account		215
Add: Provision for loss of subsidiary		60
Depreciation		100
		375
Less: Dividend income exempt under section 10(34)	20	
Depreciation	100	
Business loss which is less than unabsorbed depreciation	50	170
"Book Profit"		**205**

III. Computation of Tax liability under the normal provisions of the Income-tax Act, 1961

Total income as per the Income-tax Act, 1961 is Rs.105 Lacs,

Particulars	Rs.
Tax payable Rs.105 Lacs @ 25%, since the turnover of the company for the previous year 2015-16 does not exceed Rs.50 crore.	26,25,000
Add: Surcharge @ 7%	1,83,750
	28,08,750
Add: Education cess & SHEC@ 3%	84,263
Total Tax payable	**28,93,013**
Round off	**28,93,010**

IV. Computation of Minimum Alternate Tax

Particulars	Rs.
Tax @18.50% of book profit of Rs.205 lacs	37,92,500
Add: Surcharge @ 7%	2,65,475
	40,57,975
Add: Education cess & SHEC@ 3%	1,21,739
Minimum Alternate Tax payable	**41,79,714**
Round off	**41,79,710**

Since 18.50% of book profit exceeds the tax payable as per the Income -tax Act, 1961, the book profit of Rs.205 lacs would be deemed to be the total income and the tax payable on such total income shall be 18.5% thereof i.e. 37,92,500 plus surcharge @7% being Rs.2,65,475 plus education cess and SHEC @3% (of tax and surcharge) being Rs.1,21,739. Total tax liability would be Rs.41,79,710.

Note: With regard to the company's representation, in respect of capital gain whether liable for book profit tax under section 115JB, it may be noted that since the excess realized on sale of land has been included in net profit computed under Schedule III of the Companies Act, 2013, it will form part of book profit [Bombay High Court judgment in CIT v. Veekay Lal Investment Co. Pvt. Ltd. (2001) 249 ITR 597].

Illustration 2

Maitri Jeans (P) Ltd. is in the business of manufacturing jeans. For the assessment year 2018-19, it paid tax @18.50% on its book profit computed under section 115JB. The Assessing Officer though satisfied that it is liable to pay book profit tax U/s. 115JB, wants to charge interest under sections 234B and 234C as no advance tax was paid during the financial year 2017-18. The company seeks your opinion on the proposed levy of interest. Advice.

Solution

The issue under consideration is whether interest under sections 234B and 234C can be levied where a company is assessed on the basis of its book profit under section 115JB.

The Supreme Court, in Joint CIT v. Rolta India Ltd. (2011) 330 ITR 470, observed that there is a specific provision in section 115JB(5) providing that all other provisions of the Income -tax Act, 1961 shall apply to every assessee, being a company, mentioned in that section. Section 115JB is a self - contained code pertaining to MAT, and by virtue of sub-section (5) thereof, the liability for payment of advance tax would be attracted.

According to section 207, tax shall be payable in advance during any financial year, in accordance with the provisions of sections 208 to 219 (both inclusive), in respect of the total income of the assessee which would be chargeable to tax for the assessment year immedi ately following that financial year.

Under section 115JB(1), where the tax payable on total income is less than 18.5% of "book profit" of a company, the "book profit" would be deemed to be the total income and tax would be payable at the rate of 18.5%.

Since in such cases, the book profit is deemed to be the total income, therefore, as per the provisions of section 207, tax shall be payable in advance in respect of such book profit (which is deemed to be the total income) also.

Therefore, if a company defaults in payment of advance tax in respect of tax payable under section 115JB, it would be liable to pay interest under sections 234B and 234C.

Therefore, even though Maitri Jeans (P) Ltd. is assessed on the basis of its book profit under section 115JB for A.Y.2018-19, it is liable to pay advance tax. Since Maitri Jeans (P) Ltd. has not paid any advance tax during the financial year 2017-18, the levy of interest under section 234B and 234C is valid.

Illustration 3

Sona Ltd., a resident company, earned a profit of Rs.15 lakhs after debit/credit of the following items to its Statement of Profit and Loss for the year ended on 31/03/2018.

(i) Items debited to Statement of Profit and Loss:

No.	Particulars	`
1.	*Provision for the loss of subsidiary*	*70,000*
2.	*Provision for doubtful debts*	*75,000*
3.	*Provision for income-tax*	*1,05,000*
4.	*Provision for gratuity based on actuarial valuation*	*2,00,000*
5.	*Depreciation*	*3,60,000*
6.	*Interest to financial institution (unpaid before filing of return)*	*1,00,000*
7.	*Penalty for infraction of law*	*50,000*

(ii) Items credited to Statement of Profit and Loss:

No.	Particulars	Rs.
1.	Profit from unit established in special economic zone	5,00,000
2.	Share in income of an AOP as a member	1,00,000
3.	Income from units of UTI	75,000
4.	Long term capital gains	3,00,000

Other Information:

(i) Depreciation includes Rs.1,50,000 on account of revaluation of fixed assets.

(ii) Depreciation as per Income-tax Rules is Rs.2,80,000.

(iii) Balance of Statement of Profit and Loss shown in Balance Sheet at the asset side as at 31/03/2018 was Rs.10 lakhs which includes unabsorbed depreciation of Rs.4 lakhs.

(iv) The capital gain has been invested in specified assets under section 54EC.

(v) The AOP, of which the company is a member, has paid tax at maximum marginal rate.

(vi) Provision for income-tax includes Rs.45,000 of interest payable on income-tax.

Compute minimum alternate tax under section 115JB of the Income-tax Act, 1961, for A.Y. 2018-19, assuming that Sona Ltd. is not required to comply with the Indian Accounting Standards.

Solution

Computation of "Book Profit" for levy of MAT under section 115JB for A.Y.2018 -19

Particulars	Rs.	Rs.
Net Profit as per Statement of Profit and Loss		15,00,000
Add: Net profit to be increased by the following amounts as per Explanation 1 to section 115JB:		
- Provision for the loss of subsidiary	70,000	
- Provision for doubtful debts, being the amount set aside as provision for diminution in the value of any asset	75,000	

- Provision for income-tax Further, as per Explanation 2 to section 115JB, income-tax shall include, inter alia, any interest charged under the Act, therefore, whole of the amount of provision for income-tax including Rs.45,000 towards interest payable has to be added]	1,05,000	
- Depreciation	3,60,000	6,10,000
		21,10,000
Less: Net profit to be decreased by the following amounts as per Explanation 1 to section 115JB:		
- Share in income of an AOP as a member [In a case, where AOP has paid tax on its total income at maximum marginal rate, no income-tax is payable by the company, being a member of AOP, in accordance with the provisions of section 86. Therefore, share in income of an AOP on which no income-tax is payable in accordance with the provisions of section 86, would be reduced while computing book profit, since the same has been credited to profit and loss account]	1,00,000	
- Income from units in UTI [Income from units in UTI shall be reduced while computing the book profits, since the same is exempt under section 10(35)]	75,000	
- Depreciation other than depreciation on revaluation of assets (Rs.3,60,000 – Rs.1,50,000)	2,10,000	
- Unabsorbed depreciation or brought forward business loss, whichever is less, as per the books of account. Lower of unabsorbed depreciation Rs.4,00,000 and brought forward business loss Rs.6,00,000 as per books of accounts has to be reduced while computing the book profit]	4,00,000	7,85,000
Book Profit		**13,25,000**

Computation of MAT liability under section 115JB

Particulars	Rs.
18.50% of book profit	2,45,125
Add: Education cess@2%	4,903
Secondary and higher education cess@1%	2,451
Minimum Alternate Tax liability	2,52,479
MAT liability (rounded off)	**2,52,480**

Notes:

(1) It is only the specific items mentioned under Explanation 1 to section 115JB, which can be adjusted from the net profit as per the Statement of Profit and Loss prepared as per the Companies Act for computing book profit for levy of MAT. Since the following items are not specified there under, the same cannot be adjusted for computing book profit:
- Interest to financial institution (unpaid before filing of return) and
- Penalty for infraction of law

(2) Provision for gratuity based on actuarial valuation is an ascertained liability [CIT v. Echjay Forgings (P) Ltd. (2001) 251 ITR 15 (Bom.)]. Hence, the same should not be added back to compute book profit.

(3) As per proviso to section 115JB(6), the profits from unit established in special economic zone cannot be excluded while computing the book profit, and hence, such income would be liable for MAT.

(4) Long-term capital gains cannot be deducted while computing book profit even if such amount of capital gains is invested in specified assets under section 54EC, since book profit has to be computed by adding/deducting the items mentioned under Explanation 1 to section 115JB alone. Capital Gains reflected in the statement of profit and loss shall be part of book profit under section 115JB. Capital gains exempted under section 54EC cannot also be excluded for computing book profit. [CIT v. Veekaylal Investment Co. P. Ltd. (2001) 249 ITR 597 (Bom.) & N J Jose and Co. (P) Ltd. v. ACIT (2010) 321 ITR 132 (Ker.)]

Illustration 4

X Ltd., a domestic company, has distributed on 1/11/2017, dividend of Rs.230 lakh to its shareholders. On 1/10/2017, X Ltd. has received dividend of Rs.60 lakh from its domestic subsidiary company Y Ltd., on which Y Ltd. has paid dividend distribution tax under secti on 115-O. Compute the additional income-tax payable by X Ltd. under section 115-O.

Solution

Particulars	Rs.in lakh
Dividend distributed by X Ltd.	230
Less: Dividend received from subsidiary Y Ltd.	60
Net distributed profits	**170**
Add: Increase for the purpose of grossing up of dividend $\left[\frac{15}{(100-15)} \times 170\right]$	30
Gross dividend	**200**
Additional income-tax payable by X Ltd. u/s 115-O [15% of Rs.200 lakh]	30.00
Add: Surcharge@12%	3.60
	33.60

Add: Education cess@2% and SHEC@1%	1.01
	34.61

Illustration 5

Yaman Limited is a company in which 60% of the shares are held by Piloo Limited. Yaman Limited declared a dividend amounting to Rs.35 lacs to its shareholders for the financial year 2016-17 in its Annual General Meeting held on 10th July, 2017. Dividend distribution tax was paid by Yaman Limited on 21st July, 2017. Piloo Limited declared an interim dividend amounting to Rs.50 lacs on 15th October, 2017.

Compute the amount of tax on dividend payable by Piloo Limited.

What would be your answer, if 58% shares of Piloo Limited are held by Kafi Limited, an Indian company?

Solution

As per section 115-O, dividend distribution tax at the rate of 17.304% (i.e., 15% plus surcharge@12%, education cess@2% and secondary and higher education cess@1%) is leviable on dividend declared, distributed or paid by a domestic company. As per section 115 - O(1A), a holding company receiving dividend from its domestic subsidiary company can reduce the same from dividend declared, distributed or paid by it. The dividend from its domestic subsidiary company should be received in the same financial year in which the holding company declares, distributes or pays the dividend. Further, the dividend shall not be considered for reduction more than once.

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5 As per sub-section (1B) of section 115-O, for the purpose of grossing up, the rate specified in sub-section (1) has to be considered. The rate specified in sub-section (1) is 15%. Further, in the example given in the Explanatory Memorandum to the Finance (No.2) Bill, 2014, grossing up has been done at the rate of 15%. However, it is also possible to take a view that grossing up should be done at the rate of **17.304%** (that is, 15% plus surcharge@**12%** plus education cess and SHEC@3%), which is the effective rate of dividend distribution tax.

The conditions to be fulfilled for this purpose are as follows:

(1) The domestic subsidiary company should have paid the dividend distribution tax which is payable on such dividend;

(2) The recipient holding company should be a domestic company;

For this purpose, a holding company is a company which holds more than 50% of the nominal value of equity shares of another company.

Section 115-O (1B) provides that for the purposes of determining the tax on distributed profits payable in accordance with section 115-O, any amount by way of dividends referred to in section 115-O(1), as reduced by the amount referred to in section 115-O(1A) [referred to as net distributed profits], shall be increased to such amount as would, after reduction of the tax on such increased amount at the rate specified in section 115 -O(1), be equal to the net distributed profits.

On the basis of the aforesaid provision, dividend distribution tax payable by Piloo Limited shall be computed as follows:

Particulars	Rs.in lakh
Dividend distributed by Piloo Ltd.	50.00
Less: Dividend received from subsidiary Yaman Ltd. (60% of Rs.35 lacs)	21.00
Net distributed profits	29.00
Add: Increase for the purpose of grossing up of dividend Rs.29 x 100 /85 = Rs.34.12 minus Rs.29.00	5.12
Gross dividend	34.12
Additional income-tax payable by Piloo Ltd. u/s 115-O [15% of Rs.34.12 lakh]	5.12
Add: Surcharge@12%	0.61
	5.73
Add: Education cess@2% and SHEC@1%	0.17
	5.90

In order to remove the cascading effect of DDT in a multi -tier corporate structure, section 115- O provides that, in case any domestic company (Piloo Ltd., in this case) receives any dividend during the year from any subsidiary company (Yaman Ltd., in this case) and such subsidiary company (Yaman Ltd.) has paid the DDT as payable on such dividend, then, dividend distributed by the holding company (Piloo Ltd.,) in the same year to the extent of dividend received from the subsidiary (Yaman Ltd.), shall not be subject to DDT under section 115 -O, irrespective of whether the holding company (Piloo Ltd.) is a subsidiary of any other company (Kafi Ltd., in this case).

Therefore, in spite of the fact that Piloo Ltd. is a subsidiary of Kafi Ltd., it can reduce the amount of dividend received from Yaman Ltd. for computation of dividend distribution tax. Therefore, dividend distribution tax payable by Piloo Ltd. shall be 17.304% of Rs.34.12 lacs (grossed up amount) i.e. Rs.5.90 lacs.

Illustration 6

XYZ Ltd., a domestic company, purchases its own unlisted shares on 4th July, 2017. The consideration for buyback amounted to Rs.21 lakh, which was paid on the same day. The amount received by the company two years back for issue of such shares determined in the manner specified in Rule 40BB was Rs.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, 2017.

Solution

XYZ Ltd is liable to pay Rs.1,84,576 as additional income-tax, which is the amount calculated @23.072% (20% plus surcharge@**12%** plus cess@3%) on Rs.8 lakh, being its distributed income (i.e., Rs.21 lakh – Rs.13 lakh).

The additional income-tax was payable on or before 18th July, 2017. However, the same was paid only on 29th September 2017.

Period for which interest@1% per month or part of a month is leviable -

Period	No. of months/part of month
19th July – 18th August, 2017 (whole of first month)	1
19th August – 18th September, 2017 (whole of second month)	1
19th September – 29th September, 2017 (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., Rs.1,84,500 (rounded off as per Rule 119A). Therefore, interest payable under section 115QB is Rs.5,535.

Illustration 7

A business trust registered under SEBI (Real Estate Investment Trusts) Regulations, 2014, gives its income for the P.Y.2017-18:

income from Beta Ltd. – Rs.4 crore; d income from Beta Ltd.

– Rs.2 crore;

(1) Short-term capital gains on sale of listed shares of Beta Ltd. – Rs.1.5 crore;

(2) Short-term capital gains on sale of developmental properties – Rs.1 crore

(3) Interest received from investments in unlisted debentures of real estate companies – Rs.10 lakh;

(4) Rental income from directly owned real estate assets – Rs.2.50 crore

Beta Ltd. is an Indian company in which the business trust holds controlling interest. The business trust holds 100% of the shareholding of Beta Ltd.

Discuss the tax consequences of the above income earned by the business trust in the hands of the business trust and the unit holders, assuming that the business trust has distributed Rs.10 crore to the unit holders in the P.Y.2017-18.

Solution

Tax consequences in the hands of the business trust and its unit holders

(1) **Interest income of Rs.4 crore from Beta Ltd.:** There would be no tax liability in the hands of business trust due to pass-through status enjoyed by it under sub-clause (a) of section 10(23FC) in respect of interest income from Beta Ltd., being the special purpose vehicle. Therefore, Beta Ltd. is not required to deduct tax at source on interest payment to the business trust.

However, the business trust has to deduct tax at source under section 194LBA –

- @ 10%, on interest component of income distributed to resident unit holders; and
- @ 5%, on interest component of income distributed to non-corporate non-resident unit holders and foreign companies.

Interest component of income distributed to unit holders is taxable in the hands of the unit holders – @ 5%, in case of unit holders, being non-corporate non-residents or foreign companies; and at normal rates of tax, in case of resident unit holders.

The interest component of income received from the business trust in the hands of each unit - holder would be determined in the proportion of 4/11.1, by virtue of section 115UA(1).

(2) **Dividend income of Rs.2 crore from Beta Ltd.:** The dividend distributed by the SPV to the business trust is exempt by virtue of section 115-O(7), since the SPV is a specified domestic company in which the business trust has become the holder of whole of the nominal value of equity share capital of the company. Further, there would be no tax liability in the hands of the business trust, due to specific exemption provided under sub-clause (b) of section 10(23FC).

Any distributed income referred to in section 115UA, to the extent it does not comprise of interest [referred to in sub-clause (a) of section 10(23FC)] and rental income from real estate assets owned directly by the business trust [referred to in section 10(23FCA)] received by unit holders, is exempt in their hands under section 10(23FD). Therefore, by virtue of section 10(23FD), there would be no tax liability on the dividend component [referred to in sub -clause (b) of section 10(23FC)] of income distributed to unit holders in their hands.

(3) **Short-term capital gains of Rs.1.50 crore on sale of listed shares of Beta Ltd.:** As per section 115UA(2), the business trust is liable to pay tax@15% under section 111A in respect of short - term capital gains on sale of listed shares of special purpose vehicle. There would, however, be no tax liability on the capital gain component of income distributed to unit holders, by virtue of the exemption contained in section 10(23FD).

(4) **Short-term capital gains of Rs.1 crore on sale of developmental properties:** It is taxable at maximum marginal rate of 35.535% in the hands of the business trust as per section 115UA(2). There would be no tax liability in the hands of the unit holders on the capital gain component of income distributed to them, by virtue of the exemption contained in section 10(23FD).

(5) **Interest of Rs.10 lakh received in respect of investment in unlisted debentures of real estate companies:** Such interest is taxable@35.535%, being the maximum marginal rate, in the hands of the business trust, as per section 115UA(2). However, there would be no tax liability in the hands of the unit holders on the interest component of income distributed to them, by virtue of section 10(23FD).

(6) **Rental income of Rs.2.50 crore from directly owned real estate assets:** Any income of a business trust, being a REIT, by way of renting or leasing or letting out any real estate asset owned directly by such business trust is exempt in the hands of the trust as per section 10(23FCA).

Where the income by way of rent is credited or paid to a business trust, being a REIT, in respect of any real estate asset held directly by such REIT, no tax is deductible at source under section 194-I.

The distributed income or any part thereof, received by a u nit holder from the REIT, which is in the nature of income by way of renting or leasing or letting out any real estate asset owned directly by such REIT is deemed income of the unit holder as per section 115UA(3). The business trust has to deduct tax at source@10% under section 194LBA in case of distribution to a resident unit holder and at rates in force in case of distribution to a non-resident unit holder.

The rental income component received from the business trust in the hands of each unit -holder would be determined in the proportion of 2.5/11.1, by virtue of section 115UA(1).

Notes:

(1) Chapter XII-FA contains the special provisions relating to business trusts. Section 115UA(1) provides that any income distributed by a business trust to its unit holder s shall be deemed to be of the same nature and in the same proportion in the hands of the unit holder, as it had been received by, or accrued to the business trust.

(2) Sub-clause (a) of section 10(23FC) exempts any income of a business trust by way of int erest received or receivable from a Special Purpose Vehicle (SPV). Thus, the business trust enjoys a pass-through status in respect of interest received or receivable from a SPV.

(3) Sub-clause (b) of section 10(23FC) exempts any income of a business trust by way of dividend received from SPV, being a specified domestic company in which a business trust has become the holder of the whole of the nominal value of equity share capital of the company. Such dividend income is also exempt in the hands of the unit-holder.

(4) SPV means an Indian company in which the business trust holds controlling interest and any specific percentage of shareholding, as may be required by the regulations under which such trust is granted registration [not less than **51%** as per the current SEBI (Real Estate Investment Trusts) Regulations, 2014].

Such company should hold not less than 80% of its assets directly in properties and should not invest in other SPVs and should not be engaged in any activity other than holding and developing property and any other activity incidental to such holding or development.

Since Beta Ltd. is an Indian company in which the business trust holds controlling interest and 100% of shareholding, it is a special purpose vehicle. It is presumed that Beta L td. fulfills the other conditions specified in the regulations to qualify as an SPV.

(5) The distributed income of the business trust, to the extent it comprises of interest referred to in sub-clause (a) of section 10(23FC) and rental income referred to in section 10(23FCA), is deemed to be the income of the unit holder in the previous year of distribution and subject to tax in the hands of the unit holder in that year. Accordingly, the business trust is required to deduct tax at source on the interest component and rental component of income distributed to its unit holders.

(6) Any distributed income referred to in section 115UA, to the extent it does not comprise of interest referred to in sub-clause (a) of section 10(23FC) and rental income referred to i n section 10(23FCA), received by unit holders is exempt in their hands under section 10(23FD).

(7) Section 115UA(2) provides that subject to the provisions of sections 111A and 112, the total income of a business trust shall be chargeable to tax at the maximum marginal rate.

Illustration 8

The following are the particulars of income of three investment funds for P.Y.201 7-18:

Particulars	A	B	C
Business Income		` in lakh	
Capital Gains		2	(2)
Income from other sources	16	14	(6)
	4	4	8

Compute the total income of the investment funds and unit-holders for A.Y.2018-19, assuming that:

(i) each investment fund has 20 unit holders each having one unit; and

(ii) income from investment in the investment fund is the only income of the unit-holder.

If Investment Fund C has the following income components for A.Y.2019-20, what would be the total income of the fund and the unit holder for that year?

Business Income Rs.2 lakh

Capital Gains Rs.9 lakh

Income from other source Rs.8 lakh

Solution

Computation of total income of the investment fund for A.Y.2018-19

Particulars	A	B	C
		`	
Business Income	Nil	2,00,000	Nil
Total Income	**Nil**	**2,00,000**	**Nil**

Computation of total income of a unit holder of the following Investment funds for A.Y. 2018-19

Particulars	A	B	C
		`	
Capital Gains	80,000	70,000	-
Income from other sources	20,000	20,000	30,000
Total Income	**1,00,000**	**90,000**	**30,000**

Notes:

(i) The total income of Investment Fund B would be chargeable to tax@30% if the fund is a company or firm and at the maximum marginal rate, in any other case.

(ii) In case of Investment Fund C, the business loss of Rs.2 lakh is set-off against income from other sources of Rs.8 lakh. Loss of Rs.6 lakh under the head capital gains cannot be set-off. The same has to be carried forward by the Investment Fund for set-off in the subsequent years.

(iii) For A.Y.2019-20, the brought forward capital loss of Rs.6 lakh can be set-off against capital gains of Rs.9 lakh. Business income of Rs.2 lakh would be taxable in the hands of the Investment Fund. Capital gains of Rs.3 lakh (Rs.9 lakh – Rs.6 lakh) and Income from other sources of Rs.8 lakh would
be taxable in the hands of the unit-holders. The total income of each unit holder for A.Y.2019-20 would be Rs.55,000, comprising of –
Capital gains = Rs.15,000 [i.e., Rs.3 lakh/20]
Income from other sources = Rs.40,000 [i.e., Rs.8 lakh / 20]

Illustration 9

Mr. Rajesh has income of Rs.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. 2018-19. The profit from such business included in the business income is Rs.20 lakhs. Compute the tax payable by Mr. Rajesh, assuming that he has no other income during the P.Y.2017-18.

Solution

Computation of regular income-tax payable under the provisions of the Act

Particulars	Rs.
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 Rs.2,50,000	Nil
5% on next Rs.2,50,000	12,500
20% on next Rs.5,00,000	1,00,000
30% on balance Rs.15,00,000	4,50,000
	5,62,500

Computation of Alternate Minimum Tax (AMT)

Particulars	Rs.
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% × 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 Rs.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.201 8-19 would, therefore, be Rs.8,32,500 plus education cess@2% and secondary and higher education cess@1%, totaling Rs.8,57,475.

Mr. Rajesh would be eligible for credit to the extent of Rs.2,78,100 [Rs.8,57,475 – Rs.5,79,375 (i.e., Rs.5,62,500 + 3% cess)] to be set-off in 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 15 assessment years.

(2) Assessment of Individuals

Illustration 10

Mr. Ram (aged 56) is Karta of his HUF. The HUF consists of himself, his wife and two sons viz. Mr. C (aged 28) and Minor D (aged 16). The HUF is assessed to income tax and has business income from the year 2010-11 onwards. The business income of HUF for the year ended 31.3.2018 is Rs.5,00,000 (computed). Mr. Ram is employed in a private company and his salary income for the same period is Rs.6,10,000 (computed).

You are requested to answer the following treating each of them as independent situations:

(i) Mr. C gave cash gift of Rs.1,00,000 to the HUF of Mr. Ram. What would be the total income of HUF?

(ii) The HUF has one house property fetching rent of Rs.10,000 per month and some movable assets. There is a proposal to make a partial partition of HUF by allotting the house property to Mr. C. Is it advisable to do a partial partition?

(iii) Minor D earned Rs.70,000 by use of his special skill and talent. How would his income be taxed?

(iv) A car owned personally by Mr. Ram was blended with HUF during the year. It was leased out for a monthly rent of Rs.10,000 from 1-10-2017. How would this income be taxed?

Solution

(i) Cash gift of Rs.1 lakh by Mr. C, Ram's major son, to the HUF of Mr. Ram would not be taxable in the hands of the HUF, since gifts from a relative of the HUF does not fall within the scope of income taxable under section 56(2)(x). Since Mr. C, being Mr. Ram's son, is a member of Ram's HUF, he is a relative of the HUF. Hence the total income of HUF would be Rs.5 lakhs, being the business income computed.

Note - Salary income of Mr. Ram, the Karta of the HUF, who is employed in a private company would be taxed in his individual hands, since the remuneration earned by the Karta on account of the personal qualifications and exertions and not on account of the investment of the family funds cannot be treated as income of the HUF.

(ii) Partial partition (after 31.12.1978) is not recognized and the HUF, which has been hitherto assessed to tax, shall continue to be liable to be assessed as if no such partial partition has taken place [Section 171(9)].

The rental income in this case would continue to be assessed in the hands of the HUF, even after partial partition. Therefore, it is not advisable to do a partial partition.

(iii) Income of Rs.70,000 earned by Minor D by use of his special skill and talent would be taxable in his individual hands. It will not be included in the hands of his parent by virtue of the exception to section 64(1A) contained in the proviso to section 64(1A) .

(iv) As per section 64(2), where a member of the HUF blends his self-acquired property for inadequate consideration with the HUF, income derived therefrom is deemed to arise to the transferor-member and not to the HUF. In this case, Mr. Ram has blended his personal property (i.e., car) with the HUF.Since there is no consideration in case of blending, the income from car computed in the prescribed manner, [which can be as per the presumptive provisions or lease rental of Rs.60,000 (Rs.10,000 × 6 months) less depreciation] would be deemed as the income of Mr. Ram.

(4) Assessment of Local Authority

Illustration 11

M/s. HIG, a firm, consisting of three partners namely, H, I and G, carried on the business of purchase and sale of television sets in wholesale and manufacture and sale of pens under a deed of partnership executed on 1.4.2010. H, I and G were partners in their individual capacity.

The deed of partnership provided for payment of salary amounting to Rs.1,25,000 each to H and G, who were the working partners. A new deed of partnership was executed on 1.10.2017 which, apart from providing for payment of salary to the two working partners as mentioned in the deed of partnership executed on 1.4.2010, for the first time provided for payment of simple interest @ 12% per annum on the balances standing to the credit of the Capital accounts of partners from 1.4.2017.

The firm was dissolved on 31.3.2018 and the capital assets of the firm were distributed among the partners on 20.4.2018. The net profit of the firm for the year ended 31.3.2018 after payment of salary to the working partners and debit/credit of the following items to the Profit and Loss Account was Rs.1,50,000:

(i) Interest amounting to Rs.1,00,000 paid to the partners on the balances standing to the credit of their capital accounts from 1.4.2017 to 31.3.2018.

(ii) Interest amounting to Rs.50,000 paid to the partners on the balances standing to the credit of their Current accounts from 1.4.2017 to 31.3.2018

(iii) Interest amounting to Rs.20,000 paid to the Hindu undivided family of partner H @ 18% per annum.

(iv) Payment of Rs.25,000 towards purchase of television sets (stock in trade) made by crossed cheque on 1.11.2017.

(v) Rs.30,000 being the value of gold jewellery received as gift from a manufacturer for achieving sales target.

(vi) Depreciation amounting to Rs.15,000 on motor car bought and used exclusively for business purposes, but registered in the name of partner 'H'.

(i) Depreciation under section 32(1)(ii) amounting to Rs.37,500 of new machinery bought and installed for manufacture of pens on 1.11.2017 at a cost of Rs.5,00,000.

(ii) Interest amounting to Rs.25,000 received from bank on fixed deposits made out of surplus funds.

The firm furnishes the following information relating to it:

(a) Closing stock-in-trade was valued at Rs.60,000 as per the method of lower of cost or net realizable value consistently followed by it. The net realizable value of the closing stock - in-trade was Rs.65,000.

(b) Brought forward business loss relating to the assessment year 2017-18 was Rs.50,000.

(c) The fair market value of the capital assets as on 31.3.2018 was Rs.20,00,000 and the cost of their acquisition was Rs.15,00,000.

Compute the total income of M/s. HIG for the assessment year 2018 -19.

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

Solution

Computation of total income of M/s. HIG for the A.Y. 2018-19

Particulars	Rs.	Rs.
Net profit as per profit & loss account		1,50,000
Add: Interest to partners on capital accounts for the period from 1.4.2017 to 30.9.2017 disallowed (total interest Rs.1,00,000 but deduction limited to 6 months only hence 50% thereof is deductible and the balance is added) **[Note (i)]**	50,000	
Interest to partners on current accounts from 1.4.2017 to 31.3.2018–not authorized by the deed, hence disallowed **[Note (ii)]**.	50,000	
100% of Rs.25,000 paid towards purchase of television sets otherwise than by way of account payee cheque (being stock in trade, hence disallowed) **[Note (iv)]**.	25,000	
Difference on account of valuation of closing stock-in-trade at market value (Rs.65,000 less Rs.60,000) **[Note (ix)]**	5,000	
Salary paid to working partners considered separately.	2,50,000	3,80,000
		5,30,000
Less: Additional depreciation on new machinery (Rs.5,00,000 x 20%) = Rs.1,00,000. Only 50% is allowable as deduction. **[Note (vii)]**		50,000
		4,80,000
Less: Interest received from bank on fixed deposits considered separately		25,000
		4,55,000
Less: Salary to working partners -		
(i) As per limit in section 40(b)		

On first Rs.3,00,000 @ 90%	2,70,000	
On the balance of Rs.1,55,000 @ 60%	93,000	
	3,63,000	
(ii) Salary actually paid	2,50,000	
Deduction allowed being (i) or (ii) whichever is less		2,50,000
		2,05,000
Less: Business loss relating to assessment year 2017-18 set off		50,000
Income from business		**1,55,000**
Income from other sources		
Interest received from bank on fixed deposits		25,000
Total Income		**1,80,000**

Explanation for the treatment of various items

(i) Interest to partners authorised by the partnership deed will be allowed as deduction only for the period beginning with the date of the partnership deed and not for any earlier period as per section 40(b)(iv). Therefore, interest paid to the partners on the balances standing to the credit of their capital accounts from 1.10.2017 alone is eligible for deduction, since the partnership deed was executed only on 1.10.2017. Interest for the period prior to 1.10.2017 is not allowed.

(ii) The partnership deed of 1.10.2017 provides for payment of interest on balances in capital accounts of partners only. As such, the interest paid on the balances standing to the credit of the current accounts of partners is not allowable under section 40(b). The Kerala High Court has, in Novel Distributing Enterprises v. DCIT (2001) 251 ITR 704 (Ker), on identical facts, held that interest paid to the partners on their current account balances is not allowable.

(iii) Since H is a partner in his individual capacity, interest paid to the Hindu Undivided Family of partner H does not attract disallowance under section 40(b)(iv).

(iv) Section 40A(3) provides for disallowances @100% of the expenditure incurred otherwise than by an account payee cheque / account payee bank draft or use of ECS through bank account. Since the firm has made payment of Rs.25,000 towards purchase of television sets by a crossed cheque and not by an account payee cheque, 100% of such expenditure would be disallowed.

(v) Gold jewellery valued at Rs.30,000 received as gift from a manufacturer for achieving sales target is taxable under section 28(iv), being a benefit arising from business.

(vi) Depreciation on motor car bought and used exclusively for the purposes of business is allowable though not registered in the name of the firm in view of th e ratio of the decision of the Supreme Court in Mysore Minerals Ltd. v. CIT (1999) 239 ITR 775.

(vii) The firm is entitled to additional depreciation @ 20% under section 32(1)(iia) in respect of the new machinery installed for manufacture of pens. Since the new machinery is put to

use for less than 180 days during the relevant previous year, the additional depreciation is restricted to 50% of the prescribed rate of 20% i.e. it is restricted to 10%. The balance additional depreciation can be claimed in the immediately succeeding financial year.

(viii) Interest received from bank on fixed deposits made out of surplus funds is assessable under the head 'Income from other sources'. Hence, it is not taken into account for the purpose of computing book-profit.

(ix) As per para 24 of ICDS II: Valuation of Inventories, closing stock has to be valued at net realizable value in the case of a dissolved firm. As such, the closing stock -in-trade of the firm has to be valued at the net realizable value.

(x) Net profit shown in the profit and loss account computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to all the partners constitutes book profit as per Explanation 3 to section 40(b). Carry forward and set off of business loss is covered under Chapter VI. Hence, brought forward business loss relating to the assessment year 2017-18 is not considered for calculation of book-profit.

(xi) Section 45(4) is not applicable to the firm for the assessment y ear 2018-19, though the dissolution of the firm took place on 31.3.2018, as there was no transfer by way of distribution of capital assets during the relevant previous year. The distribution of the capital assets took place on 20.4.2018. The capital gains will, therefore, be assessable in the assessment year 2019-20.

Illustration 12

Vijay Agencies, a partnership firm constituted by three partners with equal shares was dissolved on 1-04-2017 after a search. The tax liability of the firm outstanding to be paid was determined at Rs.15 Lacs. Out of three partners, one was declared insolvent on 18- 03-2018 by the Court. The Assessing Officer, for recovering the demand, attached the Bank Accounts of other two partners and could recover an amount of Rs.6 Lacs from the Account of one such partner. You are asked by the partners of the dissolved firm the following questions:

(i) About the liability of each of them to pay outstanding demand.

(ii) Whether the action of Assessing Officer to attach the Bank Account of partners to recover the tax demand of the dissolved firm is justified?

Solution

(i) As per section 189(3), every person who was at the time of dissolution, a partner of the firm, shall be jointly and severally liable for the amount of tax, penalty or other sum payable and all the provisions of the Act relating to assessment of such tax or imposition of such penalty or other sum, shall apply. Therefore, the three partners (till one was declared as insolvent by the Court) are jointly and severally liable for making the payment of outstanding dues of Rs.15 Lacs. After insolvency of one partner, the other two partners are jointly and severally liable to pay such demand.

(ii) Accordingly, the action of the Assessing Officer to attach the bank accounts of the partners for recovery of outstanding demand is correct and the amount of Rs.6 Lacs recovered by attachment of the bank account of one of the partners is also in order.

Illustration 13

A Pvt. Ltd. has converted into a LLP on 1.4.2017. The following are the particulars of A Pvt. Ltd. as on 31.3.2017 –

(1) Unabsorbed depreciation Rs.13.32 lakh
Business loss Rs.27.05 lakh

(2) Unadjusted MAT credit under section 115JAA Rs.8 lakh

(3) WDV of assets

Plant & Machinery (15%)	Rs.60 lakh
Building (10%)	Rs.90 lakh
Furniture (10%)	Rs.10 lakh

(4) Cost of land (acquired in the year 2000) Rs.50 lakh

(5) VRS expenditure incurred by the company during the previous year 2015-16 is Rs.50 lakh. The company has been allowed deduction of Rs.10 lakh each for the P.Y.2015-16 and P.Y.2016-17 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 31.3.2017. However, if in any subsequent year, say previous year 2018-19, 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 2018-19 would be deemed to be the income chargeable to tax of P.Y.2019-20.

(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.2017-18 would be –

Plant & Machinery	Rs.9 lakh (15% of Rs.60 lakh)
Building	Rs.9 lakh (10% of Rs.90 lakh)
Furniture	Rs.1 lakh (10% of Rs.10 lakh)

In this case, since the conversion took place on 1.4.2017, the entire depreciation is allowable in the hands of the LLP. Had the conversion taken place on any other date , say 1.7.2017, 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 (274 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., Rs.50 lakh.

(5) The LLP would be eligible for deduction of Rs.10 lakh each for the P.Y.2017-18 P.Y.2018-19, P.Y.2019-20 and under section 35DDA.

Illustration 14

JK Associates is an Association of Persons (AOP) consisting of two members, J and K. Shares of the members are: 60%(J) and 40%(K). Income of the AOP for the previous year 2017 -18 is Rs.6 lacs.

Compute tax liability of the AOP and the members in the followin g situations:

(i) J and K have their income, other than income from AOP, amounting to Rs.1 lac and Rs.2.7 lacs, respectively.

(ii) J and K's income, other than income from AOP, amount to Rs.1 lac and Rs.1.20 lacs, respectively.

Solution

Computation of tax of AOP is governed by section 167B of the Income-tax Act, 1961. Tax on total income of AOP is computed as follows:

(i) If individual share of a member is known, and the total income of any member, excluding his share from such AOP, exceeds the basic exemption limit, then the AOP will pay tax at the maximum marginal rate.

(ii) If individual share of a member is known and no member has total income (excluding his share from AOP) exceeding the basic exemption limit, then the AOP will pay tax at the rates applicable to an individual.

Section 86 provides for assessment of share in the hands of members of AOP as follows:

A member's share in the total income of AOP will be treated as follows:-

(i) If an AOP has paid tax at the maximum marginal rate or a higher rate, the member's share in the total income of AOP will not be included in his total income and will be exempt.

(ii) If the AOP has paid tax at regular rates applicable to an individual, the member's share in the income of AOP will be included in his total income and he will be allowed rebate at the average rate of tax in respect of such share.

Tax Liability of J K Associates, AOP

(i) As K's income, other than that from the AOP, exceeds the basic exemption limit, the AOP shall pay tax at maximum marginal rate of 35.535 % (i.e. 30% plus 15% surcharge plus education cess@2% plus secondary and higher education cess@1%). Thus the tax payable b y AOP = Rs.6,00,000 x 35.535 % = Rs.2,13,210.

(ii) Since none of the members have income, other than income from the AOP, exceeding the basic exemption limit, the AOP would be taxed at the rates applicable to an individual. Therefore, the AOP's tax liability = Rs.32,500 + Rs.975 = Rs.33,475.

Tax Liability of J and K

	Particulars	J Rs.	K Rs.
(i)	Share of profit from AOP	Exempt	Exempt
	Income from other sources	1,00,000	2,70,000
	Total Income	1,00,000	2,70,000
	Tax liability	NIL	1,000
	Less: Rebate under section 87A	-	1,000
	Total tax payable	NIL	NIL
(ii)	Share of profit from AOP	3,60,000	2,40,000
	Income from other sources	1,00,000	1,20,000
	(A)	4,60,000	3,60,000
	Tax liability	10,500	5,500
	Add: Education cess@2% + SHEC@1%	315	165
	Total tax payable (B)	**10,815**	**5,665**
	Average rate of tax [B/A x 100]	2.351%	1.573%
	Total tax liability	10,815	5,665
	Less: Rebate under section 86 read with section 110		

in respect of share of profit from AOP (share in AOP x Average rate of tax)	8,464	3,775
Tax liability of members	2,351	1,890

(6) Assessment of Co-operative Societies

Illustration 15

Transfer fees are received by a cooperative housing society from its incoming and outgoing members. Are such transfer fees liable to tax in the hands of the cooperative society?

Solution

The issue under consideration is whether the transfer fees received by a co -operative housing society from its incoming and outgoing members is taxable or exempt on the principle of mutuality.

On this issue, the High Court, in Sind Co-operative Housing Society v. ITO (2009) 317 ITR 47, observed that under the bye-laws of the society, charging of transfer fees had no element of trading or commerciality. Both the incoming and outgoing members have to contribute to the common fund of the assessee. The amount paid was to be exclusively used for the benefit of the members as a class.

The High Court, therefore, held that transfer fees received by a co-operative housing society, whether from outgoing or from incoming members, is not liable to tax on account of the principle of mutuality, since the predominant activity of such co-operative society is maintenance of property of the society and there is no taint of commerciality, trade or business.

Further, section 28(iii), which provides that income derived by a trade, professional or similar association from specific services performed for its members shall be treated as business income, can have no application since the co-operative housing society is not a trade or professional association.

Applying the rationale of the above ruling, transfer fees received by a co -operative housing society from its incoming and outgoing members would not be liable to tax in the hands of the co -operative society.

(7) Assessment of Mutual Concerns

EXERCISE

Question 1

XYZ Ltd. is engaged in the manufacture of textile since 01-04-2009. Its Statement of Profit & Loss shows a profit of Rs.700 lakhs after debit/credit of the following items:

(1) Depreciation calculated on the basis of useful life of assets as per provisions of the Companies Act, 2013 is Rs.50 lakhs.

(2) Employer's contribution to EPF of Rs.2 lakhs and Employees' contribution of Rs.2 lakhs for the month of March, 2018 were remitted on 8th May 2018

(3) The company appended a note to its Income Statement that industrial power tariff concession of Rs.2.5 lakhs was received from the State Government and credited the same to P & L Account.

(4) The company had provided an amount of Rs.25 lakhs being sum estimated as payable to workers based on agreement to be entered with the workers union towards p eriodical wage revision

once in 3 years. The provision is based on a fair estimation on wage and reasonable certainty of revision once in 3 years.

(5) The company had made a provision of 10% of its debtors towards bad and doubtful debts. Total sundry debtors of the company as on 31-03-2018 was Rs.200 lakhs.

(6) A debtor who owed the company an amount of Rs.40 lakhs was declared insolvent and hence, was written off by debit to Profit and loss account.

(7) Sundry creditors include an amount of Rs.50 lakhs payable to A & Co, towards supply of raw materials, which remained unpaid due to quality issues. An agreement has been made on 31 - 03-2018, to settle the amount at a discount of 75% of the outstanding. The amount waived is credited to Profit and Loss account.

(8) The opening and closing stock for the year were Rs.200 lakhs and Rs.255 lakhs, respectively. They were overvalued by 10%.

(9) Provision for gratuity based on actuarial valuation was Rs.500 lakhs. Actual gratuity paid debited to gratuity provision account was Rs.300 lakhs.

(10) Commission of Rs.1 lakhs paid to a recovery agent for realization of a debt. Tax has been deducted and remitted as per Chapter XVIIB of the Act.

(11) The company has purchased 500 tons of industrial paper as packing material at a price of Rs.30,000/ton from PQR, a firm in which majority of the directors are partners. PQR's normal selling price in the market for the same material is Rs.28,000/ton.

Additional Information:

(1) There was an addition to Plant & Machinery amounting to Rs.50 lakhs on 10-06-2017, which was used for more than 180 days during the year. Additional depreciation has not been adjusted in the books.

(2) Normal depreciation calculated as per income-tax rules is Rs.80 lakhs.

(3) The company had credited a sub-contractor an amount of Rs.10 lakhs on 31-03-2017 towards repairing a machinery component. The tax so deducted was remitted on 31-12-2017.

(4) The company has collected Rs.7 lakhs as sales tax from its customers and paid the same on the due dates. However, on an appeal made, the High Court directed the Sales Tax Department to refund Rs.3 lakhs to the company. The company in turn refunded Rs.2 lakhs to the customers from whom the amount was collected and the balance of Rs.1 lakh is still lying under the head "Current Liabilities".

Compute total income and tax payable for A.Y. 2018-19. Ignore MAT provisions.

Note - The turnover of XYZ Ltd. for the P.Y.2015-16 was Rs.55 crore.

Answer

Computation of Total Income of XYZ Ltd. for the A.Y.2018-19

Particulars	Amount (Rs.)	
Profits and Gains from Business and Profession		
Profit as per Statement of profit and loss account		7,00,00,000
Add: Items debited but to be considered separately or to be disallowed		

(a)	Depreciation as per Companies Act, 2013 disallowed	50,00,000	
(b)	Employees' contribution to EPF **[See Note 1 below]**	2,00,000	
	[Since employees' contribution to EPF has not been deposited on or before the due date under the PF Act, the same is not allowable as deduction as per section 36(1)(va). Since the same has been debited to profit and loss account, it has to be added back for computing business income].		
(c)	Employers contribution to EPF [As per section 43B, employers' contribution to EPF is allowable as deduction since the same has been deposited on or before the 'due date' of filing of return under section 139(1). Since the same has been debited to profit and loss account, no further adjustment is necessary]	Nil	
(d)	Industrial power tariff concession received from State Government	Nil	
	[Any assistance in the form of, inter alia, concession received from the Central or State Government would be		
	treated as income as per section 2(24)(xviii). Since the same has been credited to profit and loss account, no adjustment is required.		
(e)	Provision for wages payable to workers	Nil	
	[The provision is based on fair estimate of wages and reasonable certainty of revision, the provision is allowable as deduction, since ICDS X requires 'reasonable certainty for recognition of a provision, which is present in this case. As the provision has been debited to profit and loss account, no adjustment is required while computing business income]		
(f)	Provision for doubtful debts [10% of Rs.200 lakhs] [Provision for doubtful debts is allowable as deduction under section 36(1)(viia) only in case of banks, public financial institutions, state financial corporations, state industrial investment corporations and non-banking financial corporations. Such provision is not allowable as deduction in the case of a manufacturing company. Since the same has been debited to profit and loss account, it has to be added back for computing business income]	20,00,000	

(g)	Bad debts written off [Bad debts write off in the book of account is allowable as deduction under section 36(1)(vii). Since the same has already been debited to profit and loss account, no further adjustment is required]	Nil	
(h)	Discount given by Sundry Creditors for supply of raw materials [Discount of 75% given by Sundry Creditors for supply of raw materials is taxable under section 41(1). Since the same has already been credited to profit and loss account, no further adjustment is required]	Nil	
(i)	Provision for gratuity	2,00,00,000	
	[Provision of Rs.500 lakhs for gratuity based on actuarial valuation is not allowable as deduction as per section 40A(7). However, actual gratuity of Rs.300 lakhs paid is allowable as deduction. Hence, the difference has to be added back]		
(j)	Commission paid to recovery agent for realization of a debt.	Nil	
	[Commission of Rs. 1 lakh paid to a recovery agent for realisation of a debt is an allowable expense under section 37 as per DCIT v. Super Tannery (India) Ltd. (2005) 274 ITR 338 (All). Since the same has been debited to profit and loss account, no further adjustment is required]		
(k)	Purchase of paper at a price higher than the fair market value	10,00,000	
	[As per section 40A(2), the difference between the purchase price (Rs.30,000 per ton) and the fair market value (Rs.28,000 per ton) multiplied by the quantity purchased (500 tons) has to be added back since the purchase is from a related party, a firm in which majority of the directors are partners, at a price higher than the fair market value]		
(l)	Sales tax not refunded to customers out of sales tax refund	1,00,000	
	[The amount of sales tax refunded to the company by the Government is a revenue receipt chargeable to tax under section 41(1). Deduction can be claimed of amount refunded to customers [CIT v. Thirumalaiswamy Naidu & Sons (1998) 230 ITR 534 (SC)]. Hence, the net amount of Rs.1,00,000 (i.e., Rs.3,00,000 minus Rs.2,00,000) would be chargeable to tax]		2,83,00,000
			9,83,00,000

Less: Items credited but to be considered separately/ permissible expenditure and allowances		
(m) Depreciation as per Income-tax Act,1961	80,00,000	
(n) Over-valuation of stock [Rs.55 lakhs × 10/110] [The amount by which stock is over-valued has to be reduced for computing business income. Rs.50 lakhs, being the difference between closing and opening stock, has to be adjusted to remove the effect of over-valuation]	5,00,000	
(o) Additional Depreciation **[See Note 2 below]** [Additional depreciation@20% is allowable on Rs.50 lakhs, being actual cost of new plant & machinery acquired on 10.06.2017, as the same was put to use for more than 180 days in the P.Y.2017-18.]	10,00,000	
(p) Payment to a sub-contractor where tax deducted last year was remitted after the due date of filing of return **[See Note 3 below]**	3,00,000	
[30% of Rs.10 lakhs, being payment to a sub-contractor, would have been disallowed under section 40(a)(ia) while computing the business income of A.Y.2017-18, since tax deducted was remitted after the due date of filing of return. However, the same is allowable in A.Y.2018-19, since the remittance has been made on 31.12.2017]		98,00,000
Total Income		**8,85,00,000**

Computation of tax liability of XYZ Ltd. for A.Y.2018-19

Particulars	Rs.
Tax @30% on the above total income (since the turnover exceeded Rs.50 crore in the P.Y. 2015-16)	2,65,50,000
Add: Surcharge@7% (since total income exceeds Rs.1 crore but less than Rs.10 crore)	18,58,500 2,46,91,500
Add: Education cess@2%	4,93,830
Secondary and higher education cess@1%	2,46,915
Total tax liability	2,54,32,245
Total tax liability (rounded off)	**2,54,32,250**

Notes:

(1) Employees contribution to PF deposited after the due date mentioned under the PF Act is not allowable as deduction as per section 36(1)(va). The same has also been affirmed by the

Gujarat High Court in CIT v. Gujarat State Road Transport Corporation (2014) 366 ITR 170. Hence, in the above solution, employees' contribution to PF has been disallowed while computing business income.

The CBDT has, vide Circular No. 22/2015, dated 17.12.2015, clarified that the employer contribution to provident fund remitted on or before due date of filing of return under section 139(1), is allowable as deduction while computing Business Income. Further, it has also clarified that the circular does not apply to claim of deduction relating to employee's contribution welfare funds which are governed by section 36(1)(va) of the Act.

Alternate View - An alternate view has, however, been expressed in CIT v. Kiccha Sugar Co. Ltd. (2013) 356 ITR 351 (Uttarakhand), CIT v. AIMIL Ltd (2010) 321 ITR 508 (Del) and CIT v. Nipso Polyfabriks Ltd (2013) 350 ITR 327 (HP) that employees contribution to PF, deducted from the salaries of the employees of the assessee, shall be allowed as deduction from the income of the employer-assessee, if the same is deposited by the employer-assessee with the provident fund authority on or before the due date of filing of return for the relevant previous year. If this view is considered, then no disallowance would be attracted in this case, since the employees' contribution has been remitted before the due date of filing of return of income.

(2) Rs.50 lakhs, being the addition to plant and machinery on 10.6.2017 qualifies for additional depreciation@20% under section 32(1)(iia). Since only the normal depreciation as per Income - tax Rules, 1962, has been debited to profit and loss account, additional depreciation of Rs.10 lakhs (being 20% of Rs.50 lakhs) has to be deducted while computing business income.

(3) Since the tax deducted during the P.Y.2016-17 was remitted only on 31.12.2017, i.e., after the due date of filing of return for A.Y.2017-18, Rs.3,00,000, being 30% of Rs.10 lakh would have been disallowed while computing the business income of that year. Since the tax deducted has been remitted on 31.12.2017, Rs.3,00,000 would be allowed as deduction while computing the business income of the A.Y.2018-19.

Question 2

Parik Hospitality Limited is engaged in the business of running hotels of 3 -star category. The company's Statement of Profit and Loss for the previous year ended 31 st March, 2018 shows a profit of Rs.152 lakhs after debiting or crediting the following items:

(a) Payment of Rs.0.25 lakh and Rs.0.30 lakh in cash on 3rd December, 2017 and 10th December, 2017 respectively for purchase of crab, lobster and squid to Mr. Raja, a fisherman, and Mr. Khalid, a middleman for these products, respectively.

(b) Contribution towards employees' pension scheme notified by the Central Government under section 80CCD for a sum of Rs.3 lakhs calculated at 12% of basic salary and Dearness Allowance payable to the employees.

(c) Payment of Rs.6.50 lakhs towards transportation of various materials procured by one of its hotels to M/s. Bansal Transport, a partnership firm, without deduction of tax at source. The firm opts for presumptive taxation under section 44AE and has furnished a declaration to this effect. It also furnished its Permanent Account Number in the tender document.

(d) Profit of Rs.12 lakhs on sale of a plot of land to Avimunya Limited, a domestic company, the entire shares of which are held by the assessee company. The plot was acquired by Parik Hospitality Limited on 1st June, 2016.

(e) Contribution of Rs.2.50 lakhs to Indian Institute of Technology with a specific direction for use of the amount for scientific research programme approved by the prescribed authority.

(f) Expense of Rs.10 lakhs on foreign travel of two directors for a collaboration agreement with a foreign company for a brewery project to be set up. The negotiation did not succeed and the project was abandoned.

(g) Fees of Rs.1 lakh paid to independent directors for attending Board meeting without deduct ion of tax at source under section 194J.

(h) Depreciation charged Rs.10 lakhs.

(i) Rs.10 lakhs, being the additional compensation received from the State Government pursuant to an interim order of Court in respect of land acquired by the State Government in the previous year 2013-14.

(j) Dividend received from a foreign company Rs.5 lakhs.

Additional information:

(i) As a corporate debt restructuring, the bank has converted unpaid interest of Rs.10 lakhs upto 31st March, 2017 into a new loan account repayable in five equal annual installments. The first installment of Rs.2 lakhs was paid in March, 2018 by debiting new loan account.

(ii) Depreciation as per Income-tax Act, 1961 Rs.15 lakhs.

(iii) The company received a bill for Rs.2 lakhs on 31st March 2018 from a supplier of vegetables for supply made in March, 2018. The bill was omitted to be recorded in the books in March, 2018. The bill was paid in April, 2018 and the necessary entry was made in the books then.

Compute total income of Parik Hospitality Limited for the Assessment Year 2018-19 indicating the reason for treatment of each item. Ignore the provisions relating to minimum alternate tax.

Answer

Computation of Total Income of Parik Hospitality Ltd. for the A.Y.2018 -19

Particulars	Amount (Rs.)	
Profits and Gains from Business and Profession		
Profit as per Statement of profit and loss		1,52,00,000
Add: Items debited but to be considered separately or to be disallowed		
(a) Payment to middleman for purchase of crab etc. in an amount exceeding Rs.10,000	30,000	
[Under section 40A(3), disallowance is attracted in respect of expenditure for which cash payment exceeding Rs.10,000 is made on a day to a person. Payment of Rs. 25,000 to fishermen for purchase of crab etc. is covered by exception under Rule 6DD. However, payment of Rs. 30,000 to middlemen for purchase of crab etc. is not covered under the		

	exception - CBDT Circular 10/2008 dated 5/12/2008].		
(b)	Contribution towards employees' pension scheme in excess of 10% of salary disallowed under section 40A(9) [Contribution to the extent of 10% of salary (basic salary + dearness allowance, if it forms part of pay for retirement	50,000	
	benefits) is allowable as deduction under section 36(1)(iva). In this case, it is presumed that dearness allowance forms part of pay for retirement benefits]		
(c)	Payment to transport contractor without deduction of tax at source	-	
	[Since the contractor opts for presumptive taxation under section 44AE and furnished a declaration to this effect, tax is not required to be deducted at source under section 194C in respect of payment to transport contractor].		
(f)	Expenses on foreign travel of two directors for a collaboration agreement which failed to materialize	10,00,000	
	[Where expenditure is incurred for a project not related the existing business and the project was abandoned without creating a new asset, the expenses are capital in nature as per Mc Gaw-Ravindra Laboratories (India) Ltd. v. CIT (1994) 210 ITR 1002 (Guj.). Brewery project is not related to the existing business of running three star hotels]		
(g)	Fees paid to directors without deducting tax at source [30% of Rs.1 lakh] [Disallowance@30% would be attracted under section 40(a)(ia) for non-deduction of tax at source from director's remuneration on which tax is deductible under section 194J]	30,000	11,10,000
			1,63,10,000
Less: Items credited but to be considered separately / Expenditure to be allowed			

(d)	Profit on sale of plot of land to 100% subsidiary [Short-term capital gains arises on sale of plot of land held for less than 24 months. However, in this case, since the transfer is to a 100% subsidiary company and the subsidiary company is an Indian company, the same would not constitute a transfer for levy of capital gains tax as per section 47(iv). Since this amount has been credited to the statement of profit and loss, the same has to be deducted for computing business income].	12,00,000	
(e)	Contribution to IIT for scientific research [Contribution to IIT for scientific research programme approved by the prescribed authority qualifies for weighted deduction@150% under section 35(2AA). Since 100% of contribution has already been debited to the statement of	1,25,000	
	profit and loss, the balance 50% has to be deducted while computing business income]6.		
(h)	Depreciation [Depreciation allowable under the Income-tax Act, 1961 is Rs.15 lakhs whereas the depreciation as per books of account debited to the statement of profit and loss is Rs.10 lakhs. Hence, the additional amount of Rs.5 lakhs has to be deducted while computing business income]	5,00,000	
(i)	Additional compensation received from State Government [Since the additional compensation has been received pursuant to an interim order of the Court, the same would be deemed as income chargeable to tax under the head "Capital Gains" in the year of final order as per section 45(5). Since the compensation has been credited to the statement of profit and loss, the same has to be deducted while computing business income]	10,00,000	
(j)	Dividend received from foreign company [Dividend received from foreign company is taxable under the head "Income from other sources". Since the said dividend has been credited to the statement of profit and loss, the same has to be deducted while computing business income]	5,00,000	
(i)	Interest paid during the year [Conversion of unpaid interest into loan shall not be construed as payment of interest for the purpose section 43B. The amount of unpaid interest converted into a new loan will be allowable as deduction only in the year in which such converted loan is actually paid. Since Rs.2 lakhs has been paid in the P.Y.2017-18, the same is allowable as deduction]	2,00,000	

(iii) Purchases omitted to be recorded in the books [Since the purchase is made in March, 2018 (i.e., P.Y.2017-18), in respect of which bill of Rs.2 lakhs received on 31.3.2018 has been omitted to be recorded in the books in that year, it has to be deducted to compute the business income [Kedarnath Jute Manufacturing Company Ltd. v. CIT (1971) 82 ITR 363 (SC)]. It is logical to assume that the company is following mercantile system of accounting.].	2,00,000	37,25,000
Income under the head "Profits and Gains of Business or Profession"		**1,25,85,000**

[6]From assessment year 2021-22 it is deductible @ 100%

Income from Other Sources		
Dividend received from foreign company [Dividend received from a foreign company is chargeable to tax under the head "Income from other sources".]		5,00,000
Gross Total Income		**1,30,85,000**
Less: Deduction under Chapter VI-A		Nil
Total Income		**1,30,85,000**

Question 3

Hyper Ltd., engaged in diversified activities, earned a profit of Rs.14,25,000 after debit/credit of the following items to its statement of profit and loss account for the year ended on 31.3.2018:

(a)	Items debited to Statement of Profit and Loss Account	**Rs.**
	Provision for loss of subsidiary	70,000
	Provision for income-tax demand	1,05,000
	Expenses on purchase/sale of equity shares	15,000
	Depreciation	3,60,000
	Interest on deposit credited to buyers on 31.3.2018 for advance received from them, on which TDS was deducted in April 2018 and was deposited on 31.7.2018	1,00,000
(b)	Items credited to Statement of Profit and Loss Account	
	Long term capital gain on sale of equity shares on which securities transaction tax was paid at the time of acquisition and sale	3,60,000
	Income from units of UTI	75,000

The company provides the following additional information:

(i) Depreciation includes Rs.1,50,000 on account of revaluation of fixed assets.

(ii) Depreciation allowable as per Income-tax Rules is Rs.2,80,000.

(iii) Brought forward Business Loss/Unabsorbed Depreciation:

F.Y.	Amount as per books		Amount as per Income-tax	
	Loss Rs.	Depreciation Rs.	Loss Rs.	Depreciation Rs.
2014-2015	2,50,000	3,00,000	2,00,000	2,50,000
2015-2016	Nil	2,70,000	1,00,000	1,80,000
2016-2017	3,50,000	3,15,000	1,20,000	2,10,000

You are required to:

(i) compute the total income of the company for the assessment year 2018 -19 giving the reasons for treatment of items and

(ii) examine the applicability of section 115JB of the Income-tax Act, 1961, and compute book profit and the tax credit to be carried forward.

Assume the tax rate applicable to Hyder Ltd for the P.Y. 2017 -18 is 30%.

Answer

Computation of total income of M/s Hyper Ltd. for the A.Y. 2018-19

Particulars	Rs.	Rs.
Profit as per Statement of Profit & Loss Account		14,25,000
Add:Items disallowed /considered separately		
Provision for loss of subsidiary [since it is not wholly and exclusively for the purpose of business of the assessee]	70,000	
Provision for income-tax [disallowed under section 40(a)(ii)]	1,05,000	
Expenses on transfer of shares [not deductible from business income. It is to be deducted from gross sale consideration while computing capital gains]	15,000	
Interest on deposit credited on 31.3.2018 and tax deducted in April 2018 which was deposited on 31.7.2018 [not allowed under section 40(a)(ia) @ 30%].	30,000	
Depreciation debited to statement of profit and loss account [only depreciation calculated as per the Income-tax Rules, 1962 is allowable as deduction]	3,60,000	5,80,000
		20,05,000
Less: Items credited but not includible under business income or are exempt under the provisions of the Act		
Long-term capital gain on sale of equity shares on which securities transaction tax was paid, since it is not a business income.	3,60,000	

Income from UTI, since it is not a business income.	75,000	4,35,000
		15,70,000
Less: Depreciation (allowable as per the Income-tax Rules, 1962)		2,80,000
		12,90,000
Less: Set-off of brought forward business loss and unabsorbed depreciation		
Brought forward business loss under section 72	4,20,000	
Brought forward depreciation under section 32	6,40,000	10,60,000
Income from business		**2,30,000**
Capital Gains		
Long term capital gain on sale of equity shares on which securities transaction tax was paid at the time of acquisition and sale	3,60,000	
Less: Exempt under section 10(38)	3,60,000	Nil
Income from Other Sources		
Income from units of UTI	75,000	
Less: Exempt under section 10(35)	75,000	Nil
Total Income		**2,30,000**
Tax payable @ 30%		69,000
Add: Education cess @ 2%	1,380	
Secondary and higher education cess @ 1%	690	2,070
Tax Payable as per the Income-tax Act, 1961		**71,070**

Computation of Book Profit under section 115JB

Particulars	Rs.	Rs.
Profit as per Statement of Profit & Loss Account		14,25,000
Add: Net Profit to be increased by the following amounts as per Explanation 1 to section 115JB		
Provision for loss of subsidiary	70,000	
Provision for income-tax	1,05,000	

Depreciation debited to profit and loss account	3,60,000	5,35,000
		19,60,000
Less: Net Profit to be reduced by the following amounts as per Explanation 1 to section 115JB		
Depreciation debited to profit and loss account (excluding depreciation on account of revaluation of fixed assets) (i.e., Rs.3,60,000 – Rs.1,50,000)	2,10,000	
Income from UTI [since it is an income exempt u/s 10(35)]	75,000	
Brought forward business loss or unabsorbed deprecation as per books of account, whichever is less, taken on cumulative basis	6,00,000	8,85,000
Book Profit		**10,75,000**
18.50% of book profit		1,98,875
Add: Education cess @ 2%	3,978	
Secondary and higher education cess @ 1%	1,989	5,967
		2,04,842

In case of a company, it has been provided that where income-tax payable on total income computed as per the provisions of the Act is less than 18.50% of book profit, the book profit shall be deemed as the total income and the tax payable on such total income shall be 18.50% thereof plus education cess @ 2% and secondary and higher education cess @ 1%.

Accordingly, in this case, since income-tax payable on total income computed as per the provisions of the Act is less than 18.50% of book profit, the book profit of Rs.10,75,000 is deemed to be the total income and income-tax is payable @ 18.50% thereof plus education cess @ 2% and secondary and higher education cess @ 1%. The tax liability, therefore, works out to be Rs.2,04,842.

Section 115JAA 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 subsequen t years. 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. This tax credit is allowed to be carried forward for 15 assessment years succeeding the assessment year in which the credit became allowable.

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 section 115JB, to the extent of excess of such tax payable over the tax payable on book profits in that year.

Particulars	Rs.
Tax on book profit under section 115JB	2,04,842
Less: Tax on total income computed as per the other provisions of the Act	71,070
Tax credit to be carried forward under section 115JAA	**1,33,772**

Note: Long-term capital gains on sale of equity shares through a recognized stock exchange on which securities transaction tax (STT) is paid is exempt under section 10(38). One of the adjustments to the book profit is that exempt income under section 10, which i s credited to statement of profit and loss account, would be deducted in arriving at the book profit. However, long -term capital gains exempt under section 10(38) is not eligible for reduction while computing book profit under section 115JB. Consequently, expenditure to earn such income should not be added back to arrive at the book profit.

Question 4

The profit as per the statement of profit and loss account of XYZ Ltd., a resident company, for the year ended 31.3.2018 is Rs.190 lacs arrived at after making the following adjustments:

	Particulars	*` (in lacs)*
(i)	*Depreciation on assets*	*100*
(ii)	*Reserve for currency exchange fluctuation*	*50*
(iii)	*Provision for tax*	*40*
(iv)	*Proposed dividend*	*120*

Following further information are also provided by company:

(a) Profit includes Rs.10 lacs, being dividend received from an Indian subsidiary company.

(b) Provision for tax includes Rs.16 lacs of tax payable on distribution of profit and of Rs.2 lacs of interest payable on income-tax.

(c) Depreciation includes Rs.40 lacs towards revaluation of assets.

(d) Amount of Rs.50 lacs credited to statement of P & L account was drawn from revaluation reserve.

(e) Balance of statement of profit and loss account shown in balance sheet at the asset si de as at 31.3.2017 was Rs.30 lacs which includes unabsorbed depreciation of Rs.10 lakhs.

Compute the book profit for the year ended 31.3.2018.

Answer

Computation of book profit of XYZ Ltd. for the year ended 31.3.2018

Particulars	Rs.	Rs.
Profit as per Statement of Profit & Loss Account		1,90,00,000
Add: Net profit to be increased by the following amounts as per Explanation 1 to section 115JB		
Depreciation on assets debited to P&L A/c	1,00,00,000	
Reserve for currency exchange fluctuation, since the amount carried to any reserve, by whatever name called, is to be added back	50,00,000	
Provision for tax **(See Note below)**	40,00,000	
Proposed dividend	1,20,00,000	3,10,00,000
		5,00,00,000

Less: Net profit to be decreased by the following amounts as per Explanation 1 to section 115JB		
Depreciation other than depreciation on revaluation of assets (Rs.100 lacs - Rs.40 lacs)	60,00,000	
Withdrawal from revaluation reserve restricted to the extent of depreciation on account of revaluation of assets (Rs.50 lacs or Rs.40 lacs, whichever is less)	40,00,000	
Unabsorbed depreciation or brought forward business loss, whichever is less, as per the books of account. Unabsorbed depreciation Rs.10 lakhs and brought forward business loss Rs.20 lakhs – whichever is less	10,00,000	
Dividend income [since the same is exempt under section 10(34)]	10,00,000	1,20,00,000
Book profit		**3,80,00,000**

Note – For the purpose of section 115JB, book profit means the profit as per the statement of profit and loss account prepared in accordance with Schedule III to the Companies Act, 2013, as adjusted by certain additions/deductions as specified. One of the adjustments is to add back income-tax paid or payable, and the provisions therefor. Explanation 2 after sub-section (2) of section 115JB clarifies that income-tax includes, inter alia, dividend distribution tax / tax on distributed income and interest. Therefore, the entire provision of Rs.40 lacs for income-tax is added back for computing book profit for levy

Question 5

Mr. Harish, aged 66, running business as a proprietor furnishes the particulars of his income for the year ended 31.03.2018 as under:

(a) Net Profit of Rs.3,65,500 from the wholesale business of textiles and fabrics arrived at after charge of following expenses in the Profit & Loss Account:
  (i) Personal travelling expenses of Rs.12,750.
  (ii) Purchase of furniture items for shop on 13.6.2017 of Rs.25,000 but charged in shop expenses.

(b) He owns a house with two floors constructed with the financial assistance of HDFC, out of which ground floor is used by him for self use and first floor was let out on rent for Rs.8,500 p.m. from April, 2017. The municipal tax paid for the whole house was of Rs.2,500 and interest paid on housing loan for the construction was Rs.52,000. Both the floors of the house are identical.

(c) He deposited insurance premium on the life of self of Rs.12,500, wife Rs.13,500, son and daughter of Rs.28,000, repaid housing loan of Rs.50,000 and paid Rs.35,000 by credit card for health insurance of himself and his family.

Compute taxable income and the amount of tax payable by Mr. Harsh on such income for the Assessment Year 2018-19.

Answer

Computation of total income of Mr. Harsh for the A.Y.2018-19

Particulars	Rs.	Rs.
Income from house property		
Self-occupied portion (50%)		
Annual Value under section 23(2)	Nil	
Less: Deduction under section 24(b)		
Interest on housing loan [Rs.52,000 × 50%]	26,000	(26,000)
Let-out portion (50%)		
Income of let out portion being rent of Rs.8,500 p.m. received for 12 months **(Rent received has been taken as the GAV in the absence of other information)**. Gross Annual Value under section 23(1) (Rs.8,500 × 12)	1,02,000	
Less: 50% of municipal taxes paid allowable in respect of rented out portion (i.e., 50% of Rs.2,500)	1,250	
Net Annual Value (NAV)	1,00,750	
Less: Deduction under section 24		
30% of NAV under section 24(a)	30,225	
Interest on housing loan under section 24(b)	26,000	44,525
		18,525
Profits and gains of business or profession		
Net profit as per profit and loss account of wholesale business of textiles and fabrics	3,65,500	
Add: Expenses charged in profit and loss account either not allowable or to be considered separately -		
Personal travelling expenses of proprietor	12,750	
Purchase of furniture wrongly debited to shop expenses	25,000	
	4,03,250	
Less: Depreciation on furniture @ 10% on Rs.25,000	2,500	4,00,750
Gross Total Income		**4,19,275**
Less: **Deduction under Chapter VI-A**		
Under section 80C - Life insurance premium		
Self	12,500	
Wife	13,500	

Son and daughter	28,000	
- Housing loan repaid	50,000	
	1,04,000	
Under section 80D [Medical insurance premium]		
Mediclaim insurance premium of Rs.35,000 [maximum deductible is Rs.30,000 where it covers a resident senior citizen]	30,000	1,34,000
Total Income		**2,85,275**
Total Income (rounded off)		2,85,280
Tax on total income of Rs.2,85,280 (The basic exemption limit for senior citizen is Rs.3,00,000 for A.Y. 2018-19)		Nil

Question 6

X, Y and HUF of Z (represented by Z) are partners with equal shares in profits and losses of a firm, M/s Popular Cine Vision, which is engaged in the production of TV serials and telefilms. In the previous year 2016-17, one partner 'A' retired, but his dues have been settled in the previous year 2017-18.

The earlier partnership deed did not authorise payment of remuneration or interest to partners. The partnership deed was revised by the partners on 1st June, 2017 to authorise payment of remuneration of

Rs.1 lac per month to each working partner and simple interest at 15% per annum on partners' capital. X, Y and Z are actively associated with the affairs of the firm.

The Profit & Loss Account of the firm for the year ended 31st March, 2018 shows a net profit of Rs.10 lacs after debiting/crediting the following:

(a) Interest amounting to Rs.5 lacs each was paid to partners on the balances standing to their capital accounts from 1stJune, 2017 to 31st March, 2018.

(b) Remuneration to the partners including partner in representative capacity Rs.30 lacs.

(c) Interest amounting to Rs.2 lacs paid to Z on loan provided by him in his individual capacity at 16% interest.

(d) Royalty of Rs.5 lacs paid to partner X, who is a professional script writer, for use of his scripts as per agreement between the firm and X. The same is authorized by partnership deed.

(e) Two separate payments of Rs.18,000 and Rs.15,000 made in cash on 1st February, 2018 to Altaf, a hairdresser, against his bill for services rendered in January, 2018 and two payments of Rs.19,000 and Rs.10,000 made in cash on 1st February and 2nd February, 2018, respectively, to Priyam, an assistant cameraman, against her bill for services provided in January, 2018.

(f) Amount of Rs.5 lacs provided in the books on 31st March 2018 as liability for remuneration to Shreya, a film artist and a non-resident. Tax deducted at source under section 195 from the amount so credited was paid on 3rd June, 2018.

(g) Amount of Rs.6 lacs provided as gratuity for the year on the basis of actuarial valuation. Gratuity actually paid to one retired employee during the year is Rs.1.50 lacs.

(h) Interest of Rs.1.20 lacs received on income-tax refund under section 244(1A) in respect of A.Y. 2015-16.

The firm has also provided the following additional information:

The amount due to A, an ex-partner, was Rs.15 lacs which was settled on 30th September, 2017 by transferring a plot of land purchased one years back having book value of Rs.10 lacs. The difference of Rs.5 lacs was credited to partners' capital accounts in their profit sharin g ratio. The value of plot for stamp duty valuation on the date of transfer was Rs.16 lacs.

Compute the total income of the firm for the assessment year 2018-19 stating the reasons for treatment of each item.

Answer

Computation of Total Income of M/s. Popular Cine Vision for the A.Y.2018-19

Particulars	Rs.	Rs.
Profits and Gains from Business or Profession		
Net Profit as per Profit & Loss A/c		10,00,000
Add: Expenses disallowed or considered separately:		
Interest to partners in excess of 12% **(Note 1)**	3,00,000	
Disallowance under section 40A(3A) for aggregate cash payment exceeding Rs.10,000 in a single day **(Note 5)**	52,000	
Provision for gratuity **(Note 8)**	4,50,000	
Partners' Remuneration	30,00,000	
Royalty paid to Partner X **(Note 4)**	5,00,000	43,02,000
		53,02,000
Less: Interest on income-tax refund **(Note 9)**		1,20,000
Book Profit		**51,82,000**
Less: Partners' remuneration allowable under section 40(b)(v)		
(i) As per limit prescribed in section 40(b)		
On first Rs.3,00,000 90%	2,70,000	
On the balance Rs.48,82,000 60%	29,29,200	
	31,99,200	
(ii) Remuneration actually paid or payable		
(Rs.1,00,000 × 10 months × 3 partners) + (Royalty Rs.5 Lacs)		
(i) or (ii) whichever is less, is deductible	35,00,000	31,99,200
		19,82,800
Capital Gain		

Short-term capital gain on transfer of land **(Note 10)**		6,00,000
Income from other sources		
Interest on income-tax refund		1,20,000
Gross Total Income		**27,02,800**
Deductions under Chapter VI-A		Nil
Total Income		**27,02,800**

Notes:

1. As per section 40(b), simple interest at 12% p.a. to partners relating to the period after the date of partnership deed is allowable. Excess interest @ 3% paid from 1st June, 2017 to 31st March, 2018 is to be disallowed. Excess interest of 3% being Rs.15,00,000 x 3/15 = Rs.3,00,000.
2. Even though Z is a partner in a representative capacity, he is still a partner. Therefore, remuneration to Z should also be subject to the limits prescribed in section 40(b). This view finds support from the decision of the Supreme Court in the case of Rashik Lal & Co. vs CIT (1998) 229 ITR 458 (SC).
3. As per Explanation 1 to section 40(b), where an individual is a partner in a firm in representative capacity, the provisions of section 40(b) shall not apply to any interest payable by the firm to such individual in his personal capacity. Z represents his HUF in the firm. However, Z gave the loan in his individual capacity. Hence, assuming that the provisions of section 40A(2) do not get attracted in this case, such interest shall be allowed as deduction in full even though the interest rate is more than 12% p.a.
4. It may be noted that the limits specified under section 40(b)(v) are applicable in case of payment of salary, bonus, commission, or remuneration, by whatever name called, to a working partner. From a plain reading of the section, it is clear that any remuneration, by whatever name called, paid to a working partner, is subject to the limits laid down in section 40(b)(v). Therefore, the royalty of Rs.5 Lacs paid to partner X would also be subject to the limits laid down in section 40(b)(v). Hence, the same has to be added back for computing book profits.
5. Section 40A(3A) provides for disallowance of any expenditure which was allowed in the earlier year and the actual payment was made subsequently and where the aggregate payment so made is otherwise than by an account payee cheque, account payee bank draft or use of ECS through bank account in a single day to a person exceeding a sum of Rs.10,000. Hence, the payments of Rs.18,000 and Rs.15,000 in cash on 1.2.2018 to Altaf, a hairdresser, shall be disallowed, since the aggregate payment of Rs.33,000 exceeds the limit of Rs.10,000.
6. The payment of bill of the assistant cameraman of Rs.19,000 on 1st February is liable for disallowance under section 40A(3) since the aggregate payment in cash on a single day has exceeded Rs.10,000.
7. As per section 40(a)(i), any sum payable to a non-resident shall not be allowed as deduction, if tax has not been deducted at source or after deduction, has not been paid on or before the due date specified under section 139(1). Tax deducted from the amount of remuneration credited to payee's account on 31st March 2018 has to be deposited latest by 31st July 2018/

30th September, 2018 (as the case may be). The firm has paid the tax on 3rd June, 2018 and hence, the remuneration shall be allowed. Since the same is already debited to profit and loss account, no further adjustment is made.

8. As per section 40A(7), any provision made for payment of gratuity to employees on their retirement or on termination of employment for any reason is disallowed. However, gratuity of Rs.1.50 lacs paid to retired employees is allowable as deduction. Hence, th e balance provision of Rs.4.50 lacs (i.e., Rs.6 lacs – Rs.1.50 lacs) is to be disallowed.
9. Interest on income-tax refund is assessable under the head "Income from other sources".
10. Distribution of a capital asset by a firm to its partner on dissolution or otherwise attracts capital gains tax liability as per the provisions of section 45(4) and the fair market value of the asset on the date of transfer is deemed to be the full value of consideration received or accruing as a result of the transfer. The words "or otherwise" includes within its scope, cases of distribution of capital assets on retirement of a partner also. [CIT vs. A. N. Naik Associates (2004) 265 ITR 346 (Bom.)]. Therefore, distribution of a plot of land on retirement of a partner would a ttract section 45(4).

    Rs.16 lacs, being the fair market value of the plot on the date of transfer, is deemed to be the full value of consideration. Therefore, the capital gain would be Rs.6 lacs (i.e., Rs.16 lacs – Rs.10 lacs).

Question 7

PQR LLP, a limited liability partnership set up a unit in Special Economic Zone (SEZ) in the financial year 2013-14 for production of washing machines. The unit fulfills all the conditions of section 10AA of the Income-tax Act, 1961. During the financial year 2016-17, it has also set up a warehousing facility in a district of Tamil Nadu for storage of agricultural produce. It fulfills all the conditions of section 35AD. Capital expenditure in respect of warehouse amounted to Rs.75 lakhs (including cost of land Rs.10 lakhs). The warehouse became operational with effect from 1st April, 2017 and the expenditure of Rs.75 lakhs was capitalized in the books on that date.

Relevant details for the financial year 2017-18 are as follows:

Particulars	Rs.
Profit of unit located in SEZ	40,00,000
Export sales of above unit	80,00,000
Domestic sales of above unit	20,00,000
Profit from operation of warehousing facility (before considering deduction under Section 35AD).	1,05,00,000

Compute income tax (including AMT under Section 115JC) payable by PQR LLP for Assessment Year 2018-19.

Answer

Computation of total income and tax liability of PQR LLP for A.Y.2018 -19
(under the regular provisions of the Income-tax Act, 1961)

Particulars	Rs.	Rs.
Profits and gains of business or profession		
Unit in SEZ	40,00,000	
Less: Deduction under section 10AA **[See Note (1) below]**	32,00,000	
Business income of SEZ unit chargeable to tax		8,00,000
Profit from operation of warehousing facility	1,05,00,000	
Less: Deduction under section 35AD **[See Note (2) below]**	65,00,000	
Business income of warehousing facility chargeable to tax		40,00,000
Total Income		**48,00,000**
Computation of tax liability (under the normal/regular provisions)		
Tax@30% on Rs.48,00,000		14,40,000
Add: Education cess@2% and SHEC@1%		43,200
Total tax liability		**14,83,200**

Computation of adjusted total income of PQR LLP for levy of Alternate Minimum Tax

Particulars	Rs.	Rs.
Total Income (as computed above)		**48,00,000**
Add: Deduction under section 10AA		32,00,000
		80,00,000
Add: Deduction under section 35AD	65,00,000	
Less: Depreciation under section 32		
On building @10% of Rs.65 lakhs[7]	6,50,000	58,50,000
Adjusted Total Income		**1,38,50,000**

[7] Assuming the capital expenditure of Rs.65 lakhs is incurred entirely on buildings

Alternate Minimum Tax@18.5%		25,62,250
Add: Surcharge@12% (since adjusted total income > Rs.1 crore)		3,07,470
		28,69,720
Add: Education cess@2% and SHEC@1%		86,092
		29,55,812
Tax liability under section 115JC (rounded off)		**29,55,810**

Since the regular income-tax payable is less than the alternate minimum tax payable, the adjusted total income shall be deemed to be the total income and tax is leviable @18.5% thereof plus surcharge@12% and cess@3%. Therefore, the tax liability is Rs.29,55,810.

AMT Credit to be carried forward under section 115JEE	Rs.
Tax liability under section 115JC	29,55,810
Less: Tax liability under the regular provisions of the Income-tax Act, 1961	14,83,200
	14,72,610

Notes:

(1) Deduction under section 10AA in respect of Unit in SEZ =

$$\text{Profit of the Unit in SEZ} \times \frac{\text{Export turnover of the Unit in SEZ}}{\text{Total turnover of the Unit in SEZ}}$$

$$\text{Rs.40,00,000} \times \frac{\text{Rs.80,00,000}}{\text{Rs.1,00,00,000}} = \text{Rs.32,00,000}$$

(2) Deduction@100% of the capital expenditure is available under section 35AD for A.Y.2018 -19 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.

Further, the expenditure incurred, wholly and exclusively, for the purposes of such specified business, shall be allowed as deduction during the previous year in which he commences operations of his specified business if the expenditure is incurred prior to the commencement of its operations and the amount is capitalized in the books of account of the assessee on the date of commencement of its operations.

Deduction under section 35AD would, however, not be available on expenditure incurred on acquisition of land.

In this case, since the capital expenditure of Rs.65 lakhs (i.e., Rs.75 lakhs – Rs.10 lakhs, being expenditure on acquisition of land) has been incurred in the F.Y.2016-17 and capitalized in the books of account on 1.4.2017, being the date when the warehouse became operational,

Rs.65,00,000, being 100% of Rs.65 lakhs would qualify for deduction under section 35AD.

Question 8

Victory Polyfibres, a partnership firm, has earned a gross total income of Rs.300 lacs for the year ended 31-3-2018. The firm has not undertaken any international transaction or specified domestic transaction during the said year.

The above includes a profit of Rs.220 lacs from an undertaking having a turnover of Rs.80 crores. This is the fifth year and deduction under section 80 -IA of the Income-tax Act, 1961 is available to the extent of Rs.200 lacs.

There are some grey areas in the taxation workings and hence, the assessee is contemplating to file the return of income on 7.12.2018, after seeking clarifications from tax experts.

Advise the assessee-firm by working out the total income and tax payable, where the return is filed on 30-09-2018 or when the same is filed on 7-12-2018.

What is the practical solution as regards obtaining clarifications, which might or might not have an impact on the total income?

Answer

As per section 80AC, while computing the total income of an assessee of a previous year **(P.Y.2017-18, in this case)** relevant to any assessment year **(A.Y.2018-19, in this case)**, any deduction is admissible, inter alia, under section 80-IA, such deduction shall not be allowed unless it furnishes a return of income for such assessment year on or before the 'due date' spec ified in section 139(1).

Since the turnover of the partnership firm has exceeded Rs.200 lacs in the previous year 2017-18, it would be subject to audit under section 44AB, in which case the 'due date' of filing its return of income for A.Y.2018-19 would be 30th September, 2018 as per section 139(1).

Computation of total income and tax liability of M/s. Victory Polyfibres for A.Y.2018 -19

I. Where the firm files its return of income on 30th September 2018:

Particulars	Rs.in lacs
Gross Total Income	300.00
Less: Deduction under section 80-IA	200.00
Total Income	**100.00**
Tax liability@ 30%	30.00
Add: Education cess@2% and secondary and higher education cess@1%	0.90
Regular income-tax payable	**30.90**
Computation of Alternate Minimum Tax payable [Section 115JC]	
Total Income	100.00
Add: Deduction under section 80-IA	200.00
Adjusted Total Income	**300.00**
Alternate Minimum Tax (AMT) @ 18.5% on Rs.300 lacs	55.50
Add: Surcharge@12% (Since adjusted total income >Rs.1 crore)	6.66
	62.16
Add: Education cess@2% and SHEC@1%	1.86
Total tax payable (AMT)	**64.02**

Since the regular income-tax payable by the firm is less than the alternate minimum tax payable, the adjusted total income shall be deemed to be the total income of the firm for P.Y.2017-18and it shall be liable to pay income-tax on such total income@18.5% **[Section 115JC(1)]**. Therefore, the tax payable for the A.Y.2018-19 would be Rs.64.02 lacs.

Tax credit for Alternate Minimum Tax [Section 115JD]	Rs.in lacs
Total tax payable for A.Y.2018-19 (Alternate Minimum Tax)	64.02

Less: Regular income-tax payable	30.90
To be carried forward for set-off against regular income-tax payable (upto a maximum of fifteen assessment years).	33.12

II. Where the firm files its return of income on 7th December 2018:

Where the firm files its return on 7-12-2018, it would be a belated return under section 139(4). Consequently, as per section 80AC, deduction under section 80-IA would not be available. In such circumstances, the gross total income of Rs.300 lacs would be the total income of the firm.

Particulars	Rs.in lacs
Income-tax@30% of Rs.300 lacs	90.000
Add: Surcharge@12% (since total income exceeds Rs.100 lacs)	10.800
Income-tax (plus surcharge)	100.800
Add: Education cess@2% and SHEC@1%	3.024
Total tax liability	**103.824**

Practical solution regarding obtaining clarifications

The practical solution regarding obtaining clarifications would be to file the return of income under section 139(1) on or before the 'due date', i.e., 30.9.2018, and claim deduction under section 80-IA. In such a case, the firm can claim deduction of Rs.200 lacs under section 80-IA. Thereafter, consequent to the clarifications obtained, if any change is required, it can file a revised return under section 139(5) within 31.3.2019 (i.e., within the end of A.Y.2018-19) which would replace the original return filed under section 139(1).

If the firm files the return of income under section 139(1) on or before 30.9.2018, its tax liability would stand reduced to Rs.64.02 lacs, as against Rs.103.824 lacs to be paid if return is furnished after due date. Further, it would also be eligible for tax credit for alternate minimum tax under section 115JD to the extent of Rs.33.12 lacs. Therefore, the firm is advised to file its return of income on or before 30.9.2018.

Question 9

Prakash, a member in two AOPs, namely, "AOP & Co." and "Prakash & Akash", provides the following details of his income for the year ended on 31.3.2018:

(a) "AOP & Co.", assessed at normal rates of tax, had credited in his account, amount of Rs.96,000 as interest on capital, Rs.4,96,000 as salary and Rs.20,000 as share of profit.

(b) A house property located at Jaipur was purchased on 1.7.2009 with the borrowed capital in "Prakash & Akash" jointly shared equally and occupied by both of them for self residential purposes. Total interest paid for the year 2017-18 on the borrowed capital was Rs.4,10,000.

Compute the income and the tax liability thereon for the A.Y. 2018-19 and support your answer with brief reasons and the provisions of the Act.

Answer

Mr. Prakash is a member in two AOPs, namely, AOP & Co. and Prakash & Akash. Though Prakash & Akash is an AOP, the income from the house property will not be assessed as income of the AOP,

but will be included in the hands of the individual members as per section 26, since the share of each member is definite and ascertainable. Hence, Prakash's share of income from house property would be assessed in his individual hands.

Since AOP & Co., has been taxed at normal rates of tax, Mr. Prakash's share income from the AOP (i.e. salary, interest on capital and his share of profit) would be inclu ded in his total income. Mr. Prakash, however, would be entitled to a relief under section 86 in respect of this income which has been included in his total income but on which tax has already been paid by the AOP. As per section 110, the relief shall be allowed at the average rate of tax calculated on the total income inclusive of such income.

Hence, the tax liability in the hands of Mr. Prakash would be as under: -

Particulars		Rs.	Rs.
Annual Value (½ share in house property used for own residence);		Nil	
Less :	Interest on loan [½ share in Rs.4,10,000] – Since the loan is borrowed on or after 1.4.1999 and is used for acquiring property within 5 years, deduction would be available upto a maximum of Rs.2,00,000. This limit of Rs.2,00,000 applies for each member separately.	2,00,000	
Loss from house property			(-) 2,00,000
Share income from AOP & Co.			
-	Interest on capital	96,000	
-	Salary	4,96,000	
-	Share of profit	20,000	6,12,000
Total Income			**4,12,000**

Particulars		Rs.
Tax on Rs.4,12,000		8,100
Add: Education Cess & SHEC @ 3%		243
Tax Liability		8,343
Less: Rebate under section 86 read with section 110 = Rs.8343 x 100/ Rs.4,12,000	2.025%	
Rebate available Rs.6,12,000 x 2.025% = Rs.12,393		
Restricted to		8,343
Tax payable		**Nil**

Question 10

T and Q are individuals, who constitute an Association of Persons, sharing profit and losses in the ratio of 2:1. For the accounting year ended 31st March, 2018, the Profit and Loss account of the business was as under:

		Figures are in Rs.'000s	
Cost of goods sold	4,250	Sales	4,900
Remuneration to:		Dividend from Indian companies	25
T	130	Capital gains-Long term (computed)	640
Q	170		
Employees	256		
Interest to:			
T	48.3		
Q	35.7		
Other expenses	111.7		
Sales-tax penalty due	39		
Net profit	524.3		
	5,565		**5,565**

Additional information furnished:

(i) Other expenses included:

(a) wrist watches costing Rs.2,500 each were given to 12 dealers, who had exceeded the sales quota prescribed under a sales promotion scheme;

(b) employer's contribution of Rs.6,000 to the Provident Fund was paid on 14th January, 2018.

(c) Rs.30,000 was paid in cash to an advertising agency for publicity.

(ii) Outstanding sales tax penalty was paid on 15th October, 2018. The penalty was imposed by the Sales-tax Officer for non-filing of returns and statements by the due dates.

T and Q had, for this year, income from other sources of Rs.3,60,000 and Rs.2,32,000 respectively.

Required to:

(i) Compute the total income of the AOP for the assessment year 2018-19; and

(ii) Discuss the tax implication for that year in the hands of the individual members.

Answer

(i) Computation of total income of the AOP for A.Y.2018-19

Particulars	Rs.
Profit & gains of business **(See Working Note below)**	3,12,300
Long term capital gain	6,40,000
Income from other sources [Dividend is exempt under section 10(34)]	-
Total income	**9,52,300**

Working Note - Computation of profits and gains of business

Particulars	Rs.	Rs.
Net profit as per profit & loss account		5,24,300
Add: Inadmissible payments		
Interest to members T & Q (Rs.48,300 + Rs.35,700)	84,000	
Advertising [Disallowance under section 40A(3) (100% of Rs.30,000 being a cash payment)]	30,000	
Remuneration to members T & Q (Rs.1,30,000 + Rs.1,70,000)	3,00,000	
Sales tax penalty **(See Note 3 below)**	39,000	4,53,000
		9,77,300
Less: Income not taxable under this head		
Dividend from Indian companies	25,000	
Long term capital gain	6,40,000	6,65,000
Profits and gains of business		**3,12,300**

Notes:

1. Since the employer's contribution to PF has been paid during the previous year itself, it is allowable as deduction.
2. Penalty imposed for delay in filing sales tax return is not deductible since it is on account of infraction of the law requiring filing of the return within the specified period. – CIT v. Ratanchand Bholanath (S.S) (1986) 160 ITR 500 (M.P.)

(ii) Tax implication in the hands of members T & Q for the A.Y.2018-19

Members of the AOP have to pay tax on their total income taking into account savings/ investments etc.

Since one of the members has individual income more than the basic exemption limit, the AOP will be assessed at the maximum marginal rate.

Since the AOP is taxed at maximum marginal rate, the share income of members is not taxable in their hands individually.

Question 11

The assessee, Pandey Co-operative Housing Society, is a registered co-operative housing society, formed with the objective of maintaining the property owned by it, to effect repairs and maintenance of the common property of the members, and to confer to the members, the usual rights and privileges. For the assessment year 2018-19, the assessee has received Rs.3 lacs as transfer fees from the transferor members and like amount from the transferees, who at the time of transfer, were not members of the society. Discuss the exigibility to tax the aforesaid receipts in the hands of the assessee.

Answer

Transfer fees received by a co-operative housing society, whether from outgoing or from incoming members, is not liable to tax on the ground of principle of mutuality where the predominant activity of

such co-operative society is maintenance of property of the society. It was so held by the Bombay High Court in Sind Co-op Housing Society v. ITO (2009) 317 ITR 47.

Further, section 28(iii), which provides that income derived by a trade, professional or similar association from specific services performed for its members shall be treated as business income, can have no application since the co-operative housing society is not a trade or professional association.

Therefore, Rs.3 lacs received as transfer fees by Pandey Co-operative Housing Society from its transferor members and its transferees, is not chargeable to tax.

SIGNIFICANT SELECT CASES

1. **Where land inherited by three brothers is compulsorily acquired by the State Government, whether the resultant capital gain would be assessed in the status of "Association of Persons" (AOP) or in their individual status?**

   CIT v. Govindbhai Mamaiya (2014) 367 ITR 498 (SC)

   Facts of the case: Three brothers inherited a property consequent to demise of their father. A part of this bequeathed land was acquired by the State Government and compensation was paid for it. On appeal, compensation was enhanced and the enhanced compensation was paid with interest.

   Issue: The issue under consideration is regarding the status in which capital gain arising on transfer of property would be assessed. The assessees' offered income in their status as "individual" but the Revenue sought to tax the same in their status as "Association of Persons" (AOP).

   High Court's Observations: The High Court found that the parties inherited the property and there was no material on record to suggest consensus ad idem between the brothers for formation of AOP. It referred to CWT v. Chander Sen (1986) 161 ITR 370 (SC) to hold that as per section 4 of the Hindu Succession Act, 1956, income from the asset inherited by a son from his father has to be assessed as income of the son individually. Further, as per section 8 of the Hindu Succession Act, 1956, the property of the father devolves on his son in his individual capacity and not as karta of HUF. Thus, it was held that the income is chargeable to tax in their individual status and not as AOP.

   Supreme Court's Observations: The Supreme Court referred to its earlier decision in the case of Meera & Co v. CIT (1997) 224 ITR 635 in which the earlier precedent in the case of CIT v. Indira Balakrishna (1960) 39 ITR 546 (SC) was followed. The Apex Court noted that "Association of Persons" means an association in which two or more persons join in a common purpose or common action.

   The Supreme Court also referred to its judgment in G. Murugesan & Bros. v. CIT (1973) 4 SCC 211. In that case, it was held that an association of persons could be formed only when two or more persons voluntarily combined together for certain purposes.

   In this case, the property in question came to the assessees' possession through inheritance i.e., by operation of law. It is not a case where any 'associat ion of persons" was formed by volition of the parties. Further, even the income earned in the form of interest is not because of any business venture of the three assessees, but is the result of the act of the Government in compulsorily acquiring the said land. Thus, the basic test to be satisfied for making an assessment in the status of AOP is absent in this case.

Apex Court's Decision: The Apex Court, accordingly, held that the income from asset inherited by the legal heirs is taxable in their individual hands and not in the status of AOP.

2. **Would the ancestral property received by the assessee after the death of his father, be considered as HUF property or as his individual property, where the assessee's father had received such property as his share when he went out of the joint family under a release deed?**

Commissioner of Income-tax v. D. L. Nandagopala Reddy (Individual) (2014) 360 ITR 0377 (Kar)

Facts of the case: In the present case, Laxmaiah Reddy had no sons and therefore, he adopted the assessee vide a registered adoption deed dated June 25, 1956. The property, which is the subject matter of the suit, originally belonged to Venkateshwaraiah (assessee's grandfather). The assessee's father (Laxmaiah Reddy), took his share in the joint family property and executed a release deed in favour of the remaining members of the joint family vide a registered release deed dated November 23, 1927 and bequeathed all his properties in favour of the assessee. The assessee, in turn, distributed the property in favour of his wife and children. This was done by oral partition which was evidenced by a memorandum of partition dated August 6, 1998.

Thereafter, a transaction was entered into by the assessee with the builder for development of the property. The Assessing Officer treated the consideration received from the builder by the assessee and his wife as their individual income and assessed the same to tax in their individual hands.

Assessing Officer's contention: The Revenue contended that when assessee's father got the property under a release deed, it ceased to be the joint family property. Since that property was bequeathed in favour of the assessee, he became its owner after the death of his father. Therefore, it was a separate property and, consequently, the income derived therefrom is assessed to tax in the hands of the assessee as separate property.

High Court's Observations: The High Court observed that the property originally belonged to Hindu Undivided Family (HUF). One of the members of the family (i.e., the assessee's father) went out of the joint family under a release deed and the remaining members continued to be the members of joint family. After the death of assessee's father and mother, the assessee, being the adopted son, became the sole surviving co-parcener. When such property came to the hands of the assessee it was not his individual property; it was the property of his H indu Undivided Family.

High Court's Decision: The High Court held that that when the property came to the hands of the assessee, it was not his self-acquired property; it was property belonging to his HUF. The assessee had given a portion of the property to his wife without a registered document, which is possible only if the property is a HUF property. If such property is treated as a self -acquired property, then assessee would have been able to give the portion of the property to his wife only by registered document.

3. **Under which head of income is rental income from plinths inherited by individual co - owners from their ancestors taxable - "Income from house property" or "Income from other sources"? Further, would such income be assessable in the hands of the individual co-owners or in the hands of the Association of Persons?**

Sudhir Nagpal v. Income-tax Officer (2012) 349 ITR 0636 (P & H)

First Issue: The first issue relates to the head of income under which rental income from plinths, inherited by individual co-owners from their ancestors, is taxable – whether "Income from house property" or "Income from other sources"?

High Court's Observations: As regards the head of income under which rental income from plinths is assessable, the High Court referred to the Division Bench judgment in Gowardhan Das and Sons v. CIT (2007) 288 ITR 481, wherein it was observed that it is the income from property consisting of any building or land appurtenant thereto which is assessed under section 22 and not the income from renting out of open land or some kutcha plinth only.

High Court's Decision: Therefore, the Court held that the income from letting out the plinths is assessable under section 56 as "Income from other sources" and not under the head "Income from house property".

Second Issue: The second issue relates to whether such rental income is assessable in the hands of the individual co-owners or in the hands of the Association of Persons. To appreciate this issue, it is necessary to understand the complete facts of the case.

Facts of the case: In the present case, five persons of the Nagpal family were co-owners of the agricultural land "Nagpal farms" inherited from their forefathers. The co -owners executed a power of attorney in favour of Mr. Sudhir Nagpal, one of the co-owners, appointing him to construct plinths on the agricultural land and to further lease out such open plinths to any party on their behalf. The co-owners had, therefore, not purchased the land for the said purpose but had inherited the land. They were owners not in their joint capacity but in their individual capacity with a definite/defined proportion of share. The co-owners filed their individual returns of income disclosing their rental income and also paid tax on such income.

The Assessing Officer, however, issued notice under section 148 to all the co -owners of the property in the name of Mr. Sudhir Nagpal on the ground that there is an association of persons formed by the co-owners and therefore, income had escaped assessment in the hands of association of persons.

The assessee contended that since no land was purchased, therefore, the status of the co -owners cannot be treated as association of persons.

The Assessing Officer did not agree with the contention of the assessee and assessed the entire rental income from the plinths as income from other sources in the hands of the association of persons and determined the tax payable by applying section 167B(2). The Commissioner (Appeals) and the Tribunal confirmed the action of the Assessing Officer.

High Court's Observations: On appeal, the High Court observed that in order to assess individuals as "association of persons", the individual co-owners should have joined their resources and thereafter, acquired property in the name of association of persons and the property should have been commonly managed. It is only in such a case that income could be assessed in the hands of "association of persons". Mere accruing of income jointly to more persons than one would not constitute them an association of persons in respect of such income. In other words, unless the associates have done some acts or performed some

High Court's Decision: In this case, the co-owners had inherited the property from their ancestors and there was nothing to show that they had acted as an association of persons. Thus, the High Court held that the rental income from the plinths has to be assessed in the status of individual and not association of persons and consequently, section 167B would not be attracted in this case.

operations together, which have helped to produce the income in question, they cannot be termed as an association of persons. Unless the members combine or join in a common purpose, it cannot be held that they have formed themselves into an association of persons.

4. **Would the interest earned on surplus funds of a club deposited with institutional members satisfy the principle of mutuality to escape taxability?**
Madras Gymkhana Club v. DCIT (2010) 328 ITR 348 (Mad.)
Facts of the case: The assessee-club providing facilities like gym, library, etc, to its members earned interest from fixed deposits which it had made by investment of its surplus funds with its corporate members.

High Court's Decision: The High Court held that interest earned from investment of surplus funds in the form of fixed deposits with institutional members does not satisfy the principle of mutuality and hence cannot be claimed as exempt on this ground. The interest earned is, therefore, taxable.

5. **Can transfer fees received by a co-operative housing society from its incoming and outgoing members be exempt on the ground of principle of mutuality?**
Sind Co-operative Housing Society v. ITO (2009) 317 ITR 47 (Bom)
High Court's Observations: On this issue, the High Court observed that under the bye-laws of the society, charging of transfer fees had no element of trading or commerciality. Both the incoming and outgoing members have to contribute to the common fund of the assessee. The amount paid was to be exclusively used for the benefit of the members as a class.

High Court's Decision: The High Court, therefore, held that transfer fees received by a co-operative housing society, whether from outgoing or from incoming members, is not liable to tax on the ground of principle of mutuality since the predominant activity of such co -operative society is maintenance of property of the society and there is no taint of commerciality, trade or business.

Further, section 28(iii), which provides that income derived by a trade, professional or similar association from specific services performed for its members shall be treated as busin ess income, can have no application since the co-operative housing society is not a trade or professional association.

6. **Would non-resident match referees and umpires in the games played in India fall within the meaning of "sportsmen" to attract taxability under the provisions of section 115BBA, and consequently attract the TDS provisions under section 194E in the hands of the payer?**
Indcom v. Commissioner of Income-tax (TDS) (2011) 335 ITR 485 (Cal.)
High Court's Observations: On this issue, the Calcutta High Court observed that, in order to attact the provisions of the section 194E, the person should be a non-resident sportsperson or non-resident sports association or institution whose income is taxable as per the provisions of section 115BBA.
The umpires and the match referees can be described as professionals or technical persons who render professional or technical services, but they cannot be said to be either non -resident

High Court's Decision: Therefore, although the payments made to non-resident umpires and the match referees are "income" which has accrued and arisen in India, the same are not taxable under the provisions of section 115BBA and thus, the assessee is not liable to deduct tax under section 194E.

sportsmen (including an athlete) or non-resident sports association or institution so as to attract the provisions of section 115BBA and consequently, the provisions of tax deduction at source under section 194E are also not attracted in this case. Though for the purpose of section 194J, match referees and umpires are considered as professionals, the tax deduction provisions thereunder are attracted only in case where the deductee is a resident individual, which is not so in the present case.

Note - *It may be noted that since income has accrued and arisen in India to the non-resident umpires and match referees, the TDS provisions under section 195 would be attracted and tax would be deductible at the rates in force.*

7. In a case where the partnership deed does not specify the remuneration payable to each individual working partner but lays down the manner of fixing the remuneration, would the assessee-firm be entitled to deduction in respect of remuneration paid to partners?
CIT v. Anil Hardware Store (2010) 323 ITR 368 (HP)

Facts of the case: The partnership deed of the assessee-firm provided that in case the book profits of the firm are up to Rs.75,000, then the partners would be entitled to remuneration up to Rs.50,000 or 90% of the book profits, whichever is more. In respect of the ne xt Rs.75,000, it is 60% and for the balance book profits, it is 40%. Thereafter, it is further clarified that the book profits shall be computed as defined in section 40(b) of the Income -tax Act, 1961, or any other provision of law as may be applicable for the assessment of the partnership firm. It has also been clarified that in case there is any loss in a particular year, the partners shall not be entitled to any remuneration. Clause 7 of the partnership deed laid down that the remuneration payable to the partners should be credited to the respective accounts at the time of closing the accounting year and clause 5 stated that the partners shall be entitled to equal remuneration.

High Court's Decision: The High Court held that the manner of fixing the remuneration of the partners has been specified in the partnership deed. In a given year, the partners may decide to invest certain amounts of the profits into other ventures and receive less remuneration than that which is permissible under the partnership deed, but there is nothing which debars them from claiming the maximum amount of remuneration payable in terms of the partnership deed. The method of remuneration having been laid down, the assessee-firm is entitled to deduct the remuneration paid to the partners under section 40(b)(v).

Notes:

(1) Payment of remuneration to working partners is allowed as deduction if it is authorized by the partnership deed and is subject to the overall ceiling limits specified in section 40(b)(v). The limits for partners' remuneration under section 40(b)(v) has rev ised upwards and the differential limits for partners' remuneration paid by professional firms and non - professional firms have been removed. 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%.

(2) The CBDT had, vide Circular No. 739 dated 25-3-1996, clarified that no deduction under section 40(b)(v) will be admissible unless the partnership deed either specifies the amount of remuneration payable to each individual working partner or lays down the manner of quantifying such remuneration.

In this case, since the partnership deed lays down the manner of quantifying such remuneration, the same would be allowed as deduction subject to the limits specified in section 40(b)(v).

8. Can interest under sections 234B and 234C be levied where a company is assessed on the basis of book profits under section 115JB?

Joint CIT v. Rolta India Ltd. (2011) 330 ITR 470 (SC)

Supreme Court's Observations: On this issue, the Supreme Court observed that there is a specific provision in section 115JB(5) providing that all other provisions of the Income -tax Act, 1961 shall apply to every assessee, being a company, mentioned in that section. Section 11 5JB is a self-contained code pertaining to MAT, and by virtue of sub-section (5) thereof, the liability for payment of advance tax would be attracted. Therefore, if a company defaults in payment of advance tax in respect of tax payable under section 115JB, it would be liable to pay interest under sections 234B and 234C.

Supreme Court's Decision: The Supreme Court, therefore, held that interest under sections 234B and 234C shall be payable on failure of the company to pay advance tax in respect of tax payable under section 115JB.

***Note** – According to section 207, tax shall be payable in advance during any financial year, in accordance with the provisions of sections 208 to 219 (both inclusive), in respect of the total income of the assessee which would be chargeable to tax for the assessment year immediately following that financial year. Under section 115JB(1), where the tax payable on total income is less than 18.5% of "book profit" of a company, the "book profit" would be deemed to be the total income and tax would be payable at the rate of 18.5%. Since in such cases, the book profit is deemed to be the total income, therefore, as per the provisions of section 207, tax shall be payable in advance in respect of such book profit (which is deemed to be the total income) also.*

9. Can long-term capital gain exempted by virtue of section 54EC be included in the book profit computed under section 115JB?

N. J. Jose and Co. (P.) Ltd. v. ACIT (2010) 321 ITR 132 (Ker.)

Facts of the case: The assessee claimed exemption under section 54E on the income from long-term capital gains by depositing amounts in specified assets in terms of the said provision. In the computation of book profit under section 115J, the assessee claimed exclusion of capital gains because of exemption available on it by virtue of section 54E. The Assessing Officer reckoned the book profits including long-term capital gains for the purpose of assessment under section 115J.

High Court's Decision: The High Court held that once the Assessing Officer found that total income as computed under the provisions of the Act was less than 30 per cent of the book profit, he had to make the assessment under section 115J which does not provide for any deduction in terms of section 54E. As long as long-term capital gains are part of the profits included in the profit and loss account prepared in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act, 1956 (*now, Statement of Profit and Loss prepared in accordance with Part II of Schedule III to the Companies Act, 2013*), capital gains cannot be excluded unless provided under the Explanation to section 115J(1A).

***Note** – It may be noted that the rationale of this decision would apply even where minimum alternate tax (MAT) is attracted under section 115JB, on account of tax on total income being less than 18.5% of book profits. If an assessee has claimed exemption under section 54EC by investing in bonds of NHAI/ RECL, within the prescribed time, the long -term capital gains so exempt would be taken into account for computing book profits under section 115JB for levy of minimum alternate tax (MAT), since Explanation 1 to section 115JB does not provide for such deduction. Further, it may be noted that even the long-term capital gain exempt under section 10(38) is included for computation of book profit under section 115JB.*

10. Can income derived by an Indian shipping company from slot charter arrangement in other ships be computed applying the special provisions under Chapter XII -G of the Income-tax Act, 1961, relating to Tonnage Tax Scheme, inspite of non-fulfillment of the condition of holding a valid certificate in respect of such ships indicating its net tonnage in force?

CIT v. Trans Asian Shipping Services (P) Ltd (2016) 385 ITR 637 (SC)

Facts of the case: The assessee-company owned a qualifying ship and fulfilled all the requisite conditions for availing tonnage tax scheme contained in Chapter XII -G of the Income- tax Act, 1961. Thus, the income generated from the qualifying sh ip is exigible to tax as per the said scheme, since it has exercised the requisite option in this behalf and submitted valid certificate in respect of such qualifying ship. In addition to the income from qualifying ship, it has also earned income from "slot charter" arrangement in other ships in the previous years relevant to the assessment years 2005-06 and 2008-09. In the return of income filed for the relevant previous years, the assessee company also included the income earned from such slot charter for the purpose of computation of income as per the tonnage tax scheme.

Revenue's contentions vis-à-vis Assessee's contention: The Assessing Officer opined that the income earned from slot charter arrangement did not qualify for the purpose of computation of tonnage income under the tonnage tax scheme, since the said income was not generated from the ship owned by it nor was such income earned from the entire ship chartered by it. He

was also of the opinion that in order to avail the benefit of Tonnage Tax Scheme, the assessee had to show that it operated a qualifying ship and it is incumbent to produce a valid certificate in respect of such ship indicating its net tonnage as provided in section 115VX(1)(b). Thus, production of valid certificate is an essential requirement contained in section 115VD which cannot be done away with because of the formula that is contained in section 115V G for the computation of tonnage income. The Revenue further contended that computation of tonnage income under the tonnage tax scheme has to be as per the provisions of section 115VG(4) which defines "Tonnage" to mean tonnage of a ship indicated in the ce rtificate referred to in section 115VX.

The assessee company, however, contended that the requirement of producing valid certificate would apply in respect of own ships and ships hired fully. It also contended that as per method of computation provided under section 115VG, the income for the full ship is to be computed on the basis of "net tonnage" shown in the valid certificate, whereas deemed tonnage in respect of slot charter arrangement in other ships has to be computed as per Rule 11Q(1) of the Income-tax Rules, 1962.

However, the Assessing Officer rejected the contention of the assessee and held that the income from slot charter arrangement could not be included for computation of tonnage income under the tonnage tax scheme.

The order of the Assessing Officer denying the benefit of applying the tonnage tax scheme under Chapter XII-G for slot charter arrangement was upheld by CIT (Appeals) and by the Appellate Tribunal.

High Court's Decision: The High Court, however, held that the income earned under slot charter arrangement comes under definition of "deemed tonnage tax" as per Explanation to section 115VG(4), therefore, the exclusion of such income while assessing the same under the special provisions was inappropriate. Accordingly, the High Court held that the assessee is eligible for tonnage tax scheme in respect of income from slot charter arrangement also.

Supreme Court's Observations: The Apex Court noted that a company would regarded as operating a ship "if it operates any ship whether owned or chartered by it in an arrangement such as slot charter, space charter or joint charter". Thus, even an arrangement such as slot charter would be regarded as operating a ship.

A perusal of the provisions of section 115VD, containing the conditions for a ship to qualify as a "qualifying ship" would indicate that all the conditions laid down therein are fulfilled by the assessee, except the condition stipulated in clause (c) which imposes an obligation on the assessee to produce a valid certificate in respect of such a ship indicating its net tonnage in force.

The Supreme Court, noted that provisions of section 115VG(4) are in two parts in so far as computation of tonnage is concerned. When it comes to tonnage of a ship, a valid certificate is to be produced. The second part of this provision talks about "deemed tonnage" in contradistinction to the "actual tonnage" mentioned in the certificate. Explanation to sub-section 115VG(4), inter alia, mentions that in so far as slot charter arrangements are concerned, purchase of such slot charter shall be treated as deemed tonnage.

The requirement of producing a certificate would not apply when entire ship is not chartered and the arrangement pertains only to purchase of slots, slot charter and an arrangement of sharing of break-bulk vessel. This position becomes abundantly clear by reading Rule 11Q(1) which specifies the basis/formula of computing deemed tonnage in respect of arrangement of slot charter.

Supreme Court's Decision: The Apex Court, accordingly, held that the requirement of producing a certificate would not apply when entire ship is not chartered and the arrangement pertains only to purchase of slots, slot charter etc. It held that the contention of the assessee is valid and the legal fiction created by section 115VG(4) is to be given proper meaning.

Accordingly, income from slot charter arrangement in other ships can be computed applying the special provisions under Chapter XII-G.

Note: *As per section 115VG(4), for the purposes of Chapter XII-G, the tonnage shall mean the tonnage of a ship indicated in the certificate referred to in section 115VX and includes the deemed tonnage computed in the prescribed manner. The manner has been prescribed in Rule 11Q of the Income-tax Rules, 1962.*

Further, the Explanation to section 115VG(4) provides that for the purposes of this sub -section, 'deemed tonnage' shall be the tonnage in respect of an arrangement of purchase of slots, slot charter and an arrangement of sharing of break-bulk vessel.

Rules 11Q(1) provides that for the purpose of Explanation to section 115VG(4), deemed tonnage in respect of an arrangement of purchase of slots and slot charter shall be computed on the following basis:

2.5 TEU = 1 Net Tonnage (1NT)

Where TEU is Twenty foot Equivalent Unit (Container of this size)

Illustration 1

An educational institution having annual receipts of Rs.1.20 crore during the P.Y. 2017-18, has to make an application to the prescribed authority before 31.3.2018 for claiming tax exemption under section 10(23C). Discuss the correctness or otherwise of this statement.

Solution

This statement is **not** correct.

According to the first proviso to section 10(23C), an educational institution having aggregate annual receipts exceeding Rs.1 crore, is required to make an application to the prescribed authority for grant of exemption under section 10(23C)(vi). Further, it is provided that such application can be made on or before 30th September of the relevant assessment year from which the exemption is sought.

Therefore, in the given case, the educational institution (having annual receipts of Rs.1.20 crore during the P.Y. 2017-18) can make an application for grant of exemption in the prescribed form to the prescribed authority on or before 30th September, 2018, for claiming exemption under section 10(23C)(vi) for previous year 2017-18.

Illustration 2

An institution having its main object as "advancement of general public utility" received Rs.30 lakhs in aggregate during the P.Y.2017-18 from an activity in the nature of trade. The total receipts of the institution, including donations, was Rs.140 lakhs. It applied 85% of its total receipts 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's total receipts had been Rs.150 lakhs (instead of Rs.140 lakhs) in aggregate during the P.Y.2017-18?

(iii) What would be your answer if the main object of the institution is "relief of the poor" and the institution receives Rs.30 lakhs from a trading activity, when its total receipts are Rs.140 lakhs 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.2017-18, since it has received Rs.30 lakhs from an activity in the nature of trade, which exceeds Rs.28 lakhs, being 20% of the total receipts of the institution undertaking that activity for the previous year. 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.2017-18, irrespective of the fact that its approval is not withdrawn or its registration is not cancelled.

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(ii) If the total receipts of the institution is Rs.150 lakhs, and the institution receives Rs.30 lakhs in aggregate from an activity in the nature of trade during the P.Y.2017-18, then it will not lose its "charitable" status since receipt of upto 20% of the total receipts of the institution in a year from such activity is permissible. The institution can claim exemption subject to fulfilment of other conditions under sections 11 to 13. Further, such activity should also be undertaken in the course of actual carrying out of such advancement of any other object of general public utility.

(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 Rs.30 lakhs from a trading activity by such an institution will not affect its "charitable" status, even if it exceeds 20% of the total receipts of the institution. The institution can claim exemption subject to fulfilment of other conditions under sections 11 to 13.

Illustration 3

(a) **"Save Wild Life"** an institution having its main object as 'preservation of wildlife', used the entire income derived from an activity in the nature of trade for its main object during the previous year ended on 31.03.2018. The institution seeks your opinion to know whether such utilization of its income be treated for "charitable purpose"? Would your answer be different, if the main object of the institution is "advancement of object of general public utility"?

(b) A charitable trust derives its income from the business of providing mineral water to various companies situated in Software Technology Park in Hyderabad. A sum of Rs.30 lacs has been derived as net income from such business activity, which has been applied for the object of general public utility. The total receipts of the trust during the P.Y. 2017-18 was Rs.140 lacs. Examine the taxability of application of the income, if the income so derived relates to the previous year 2017-18. Would your answer be different, if the trust runs a school in a backward district and applies the profits from the business for such school's activity?

Solution

(a) Section 2(15) defines "charitable purpose" to include relief of the poor, education, yoga, 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. However, the "advancement of any other object of general public utility" shall not be a charitable purpose, if the institution is carrying on any activity in the nature of trade, commerce or business, or any activity of rendering any service in relation to any trade, commerce or business, for a cess or fee or any other consideration, irrespective of the nature of use or application, or retention, of the income derived from such activity.

Therefore, preservation of wildlife is included in the definition of "charitable purpose" under

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section 2(15). Further, an institution having the preservation of wildlife as its main object would not be subject to the restrictions which are applicable to the "advancement of any other object of general public utility". Such institution would continue to retain its "charitable" status, even if it derives income from an activity in the nature of trade.

However, if an institution having its main object as "advancement of any other object of general public utility", derives income from an activity in the nature of trade during a financial year, it would lose its "charitable" status for that year, even if it applies such income for its main objects.

It may be noted that if the receipts from such activity does not exceed 20% of the total receipts in that year, then, the institution would not lose its "charitable" status, even its main object is "advancement of any other object of general public utility", if such activity is undertaken in the course of actual carrying out of such advancement of any other object of general public utility.

(b) In the first case, net income from the business of supplying mineral water to various companies i.e., Rs.30 lacs is not eligible for exemption under section 11, since the receipt from such activity exceeds 20% of total receipts (i.e., 20% of Rs.140 lakhs) during the year. This is because "advancement of any object of general public utility" would not be a charitable purpose if it involves carrying on of any activity in the nature of trade, commerce or business, for example, supply of mineral water for a consideration, as in this case. It is immaterial that the net income from such business is applied for the object of general public utility.

On the other hand, where the trust runs a school in a backward district, this restriction is not applicable. The reason is that the restriction contained in section 2(15) is applicable only to the last limb of the definition of "charitable purpose" i.e. advancement of object of general public utility. It does not affect the other limbs of the definition viz. "relief of the poor", "education", "medical relief" etc.

Section 11(4) clarifies that "property held under trust" includes a business undertaking so held. As per section 11(4A), exemption can be availed in respect of profits and gains of business, if such business is incidental to the attainment of the objectives of the trust and separate books of account are maintained in respect of such business. Therefore, in the second case, the profit from the business shall be eligible for exemption under section 11, assuming that the said business is incidental to the attainment of the objects of the trust (i.e., education) and books of account for such business activity is maintained separately.

Example

During the previous year ending 31st March, 2018, a charitable trust earned an income of Rs.1,00,000 but it received only Rs.60,000 in that year. The balance of Rs.40,000 is received in the year ending 31-3-2019.

Solution`

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DT QUESTION BANK BY YNB

Total income earned during the P.Y.2017-18	1,00,000
Actual receipt in P.Y.2017-18	60,000
Permissible accumulation @15% of Rs.1,00,000	15,000
Balance to be applied during P.Y.2017-18	45,000
Amount received in P.Y.2018-19 to be applied in P.Y.2018-19 or P.Y.2019-20	40,000

Since this amount of Rs.40,000 is received during the P.Y. 2018-19, this can be applied in the P.Y.2018-19 or in the P.Y.2019-20. If the entire amount of Rs. 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

A trust receives a sum of Rs.50,000 on 30th March, 2018. Its previous year ends on 31-3-2018.

Solution

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 31-3-2019.

(iv) Procedural Formalities: Exercise of option

Illustration 4

A charitable institution registered under section 12AA of the Income-tax Act, 1961 filled in Form No.10 for seeking permission to accumulate unapplied income under Section 11(2) of the Act for the objects of the institution and submitted it to the Assessing Officer along with the resolution for accumulation. The Assessing Officer found that the objects for which accumulation was sought were not particularised in as much as they covered the entire range of objects of the institution. Can the Assessing Officer deny the benefit of accumulation in such a case?

Solution

Section 11(2) permits a charitable trust or institution to accumulate its unspent income where 85% of the income is not applied or is not deemed to have been applied to charitable or religious purposes in India during the previous year. The institution or trust has to specify, by notice in writing given to the Assessing Officer, the purpose for which the income is being accumulated or set apart and the period for which such income is to be accumulated or set apart.

In the given case, the assessee institution sought the permission of the Assessing Officer to accumulate unapplied income for the objects of the institution. The institution had not stated any

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objects in particular for which the unspent income was sought to be accumulated or set apart. In Bharat Krishak Samaj vs. Deputy Director of Income-tax (Exemption) (2008) 306 ITR 153 (Del.), it was held that it is not necessary for a charitable trust to particularize each and every object for which accumulation is sought. It is enough if the assessee seeks permission for accumulation for the objects of the trust. Therefore, the Assessing Officer cannot deny the benefit of accumulation in such a case.

Illustration 5

MSO Foundation, a charitable institution set up on 1st April, 2017 and registered under section 12AA with effect from that date, is engaged in providing education in hotel management. The organisation acquires a building for using the same for holding classes and office activities. It has approached you for your opinion on its eligibility to claim the cost of the building and also depreciation thereon in the current year and the subsequent year. Advise the institution indicating the reasons.

Solution

(i) 15% of income from property held for charitable purposes is exempt from tax under section 11. The remaining 85% of such "income" would be exempt if it is "applied" for charitable purposes in India.

(ii) Application of the amount can be for revenue or capital purposes. As long as the expenditure is incurred out of income earned by the trust and for the purposes of carrying on the objects of the trust, it would be treated as application of income even if such expenditure is for capital purposes. Therefore, since the building is acquired by the organization for holding classes and office activities, which is for the purposes of carrying on the objects of the charitable institution i.e., for providing education in hotel management, the cost of the building would be treated as application of income.

However, section 11 provides that where the cost of building is claimed as application, no other deduction for depreciation or otherwise would be allowed as an application of income in respect of such asset for the same or any other previous year.

No claim for exemption under section 10 permissible where trust has been granted

Illustration 6

Hundi (charitable box) superscribing "contributions in this hundi form part of corpus of trust fund" kept at Lord Venkateshwara Temple, Tirumala, was opened on 30.3.2018. Cash of Rs.100 lacs and valuable articles worth Rs.250 lacs were found to have been contributed by the devotees. Discuss the tax implications.

Solution

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As per section 11(1)(d), 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 the recipient. In the given case, there is a specific declaration by the temple authorities that the contributions being put in the hundi (charity box) would form part of the corpus of the trust fund. Therefore, it is possible to take a view that those who put the contributions in the hundi give a tacit declaration that the contributions would form part of the corpus. Hence, a view can be taken that such contributions shall not be included in the total income of the recipient trust.

Further, it may be noted that the provision relating to taxability of anonymous donations under section 115BBC does not apply to voluntary contributions received by a trust or institution created or established wholly for religious purposes.

Illustration 7

Can a trust created for charitable purposes in April 2017, having filed application for registration as per section 12A on 11.4.2018, claim benefits of sections 11 and 12 from Assessment Year 2018-19?

Solution

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.

Therefore, since the trust has filed application for registration only on 11.4.2018, it cannot claim benefit of sections 11 and 12 from A.Y.2018-19. Assuming that the registration has been granted under section 12AA, the exemption would be available only from the A.Y. 2019-20, being the assessment year relevant to the previous year in which application is filed [i.e., P.Y. 2018-19.

However, where a trust has been granted registration under section 12AA in the P.Y. 2018-19, the benefit of sections 11 and 12 shall be available in respect of any income derived from property held under trust for assessment year 2018-19, being the assessment year preceding the assessment year in which application is filed i.e., A.Y.2019-20, if assessment proceedings in respect of that year is pending before the Assessing Officer as on the date of such registration.

It may be noted that exemption in respect of an earlier assessment year can be claimed only if the objects and activities of such trust or institution in the relevant earlier assessment year are the same as those on the basis of which such registration has been granted.

Illustration 8

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Help All, a trust created on 1st January, 2018 for providing relief to the poor, applied for registration under section 12A on 1st March, 2018. On that date, its corpus fund comprised only of the initial contribution made by the trustees. The Commissioner denied registration solely on the ground that the trust had not commenced any charitable activity, due to which he could not satisfy himself about the genuineness of the trust. Is the ground for denial of registration by the Commissioner justified in this case? Discuss.

Solution

The Karnataka High Court, in DIT (Exemptions) v. Meenakshi Amma Endowment Trust (2013) 354 ITR 219, opined that an application under section 12A for registration of the trust can be sought even within a week of its formation. The activities carried on by the trust are to be seen in a case where the registration is sought much later after formation of the trust.

The High Court further observed that the corpus fund included contribution made by the trustees only, which indicated that the trustees were contributing the funds by themselves in a humble way and were intending to commence charitable activities. The assessee-trust had not also collected any donation for the activities of the trust, by the time its application came up for consideration before them. When the application for registration was made, the trust, therefore, did not have sufficient funds for commencement of its activities.

The High Court observed that, with the money available with the trust, it cannot be expected to carry out activity of charity immediately. Consequently, in such a case, it cannot be concluded that the trust has not intended to do any activity of charity. In such a situation, where application is made shortly after formation of the trust, the objects of the trust as mentioned in the trust deed have to be taken into consideration by the authorities for satisfying themselves about the genuineness of the trust and not the activities carried on by it. Later on, if it is found from the subsequent returns filed by the trust, that it is not carrying on any charitable activity, it would be open to the concerned authorities to withdraw the registration granted or cancel the registration as per the provisions of section 12AA(3).

Applying the rationale of the above ruling, the Commissioner cannot deny registration solely on the ground that the trust had not commenced any charitable activity in this case, since the trust has applied for registration under section 12A within two months after its formation and the corpus fund comprised only of contribution made by the trustees. The Commissioner has to take into consideration the objects of the trust as mentioned in the trust deed to satisfy itself about the genuineness of the trust.

Illustration 9

Educare, a trust created with the objective of promoting primary education in rural areas, filed an application for registration under section 12A on 30th April, 2017. Since the application was not disposed of by the Commissioner on or before 31st October, 2017 as required under section

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12AA(2), the trust contended that it was deemed to be registered as per the provisions of section 12AA(1). Examine the correctness of contention of the trust.

Solution

As per the provisions of section 12AA(2), every order granting or refusing registration under section 12AA(1)(b), **shall** be passed by the registering authority before the expiry of six months from the end of the month in which the application was received under section 12A(1)(a) or section 12A(1)(aa).

The Supreme Court, in CIT v. Society for Promotion of Education (2016) 382 ITR 6, held that once an application under section 12AA was made and the same was not responded to within six months, the trust would be deemed as registered with effect from the date following the expiry of the six month period.

Applying the rationale of the above Supreme Court ruling in this case, the trust would be deemed as registered with effect from 1.11.2017. The contention that the trust is deemed to be registered, since its application for registration has not been disposed of within six months is, therefore, correct.

Note: The benefit of exemption under section 11 and 12 would be available from the A.Y. 2018-19, being the assessment year relevant to the financial year in which such application is made.

Illustration 10

A charitable trust, whose income can be exempt under section 11 of the Income-tax Act, 1961, was formed on 1st March, 2015. For the accounting year ended 31st March, 2018, it earned an income of Rs.3,60,000.

It filed with the Commissioner of Income-tax its application for registration on 31st August, 2017 explaining that for good and sufficient reasons, it was prevented from filing the application for so long.

Examine

(i) by which date the application for registration should have been filed;

(ii) whether such an application could have been filed before the formation of the trust;

(iii) in the absence of an order of registration from the Commissioner, can the trust be deemed to be registered;

(iv) the steps to be taken by the trust to secure exemption from income-tax;

(v) whether a certificate of registration once granted can be cancelled and if so, the conditions there for.

Solution

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(i) The requirement of filing an application for registration under section 12A within one year of creation of the trust has been removed. The application can be filed at any time now. Accordingly, the provisions of sections 11 and 12 would 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 was filed.

However, where registration has been granted to the trust under section 12AA and on the said date, assessment proceedings relating to earlier assessment years are pending, then, the benefit of sections 11 and 12 shall be available in respect of income derived from property held under trust in those years, provided the objects and activities of the trust remain unchanged.

(ii) No. The application for registration under section 12A cannot be filed before the formation of the trust.

(iii) As per section 12AA(2), every order granting or refusing registration should be passed before the expiry of 6 months from the end of the month in which the application was received under section 12A. The Supreme Court, in CIT v. Society for Promotion of Education (2016) 382 ITR 6, held that the trust would be deemed as registered if the application under section 12AA is not disposed of within the stipulated period of six months.

Therefore, in this case, the trust would be deemed as registered with effect from 1st March, 2018. The benefit of exemption under section 11 and 12 would be available from A.Y. 2018-19, being the assessment year relevant to the financial year in which the application is made.

(iv) The following are the steps to be taken by the trust to secure exemption from income- tax:

(1) The trust should be registered with the Principal Commissioner or Commissioner of Income-tax under section 12AA.

(2) The accounts of the trust for the previous year must be audited by a Chartered Accountant if its total income without giving effect to the provisions of section 11 and section 12 exceeds the maximum amount which is not chargeable to tax. The audit report in the prescribed form, duly signed and verified by the Chartered Accountant, should be furnished along with the return of income of the trust for the relevant assessment year.

(3) At least 85% of the income is required to be applied for the approved purposes.

(4) The unapplied income and the money accumulated or set apart should be invested or deposited in the specified forms or modes, after filing statement in Form 10 on or before the due date of filing return of income specified under section 139(1).

(v) Yes, the certificate of registration can be cancelled by the Commissioner. According to section 12AA, if the Commissioner is satisfied that the activities of the trust are not genuine or are not being carried out in accordance with the objects of the trust, he shall, after giving the trust a reasonable opportunity of being heard, pass an order in writing cancelling the

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registration of the trust.

Further, section 12AA(4) provides that where a trust or an institution has been granted registration, and subsequently it is noticed that its activities are being carried out in such a manner that,—

(i) its income does not enure for the benefit of general public;

(ii) it is for benefit of any particular religious community or caste;

(iii) any income or property of the trust is applied for benefit of specified persons like author of trust, trustees etc.; or

(iv) its funds are invested in prohibited modes,

then, the Commissioner may cancel the registration of such trust or institution. However, if the trust or institution proves that there was a reasonable cause for the activities to be carried out in the above manner, the registration shall not be cancelled.

I	II	III	IV	V	VI
Situation	Total donations during the year (`)	Anonymous donations received during the year (`)	Exemption (`)	Anonymous donations taxable@30% (`)	Donations subject to tax at normal rates# (`)
A	15,00,000	4,00,000	1,00,000	3,00,000	12,00,000
B	30,00,000	7,00,000	1,50,000	5,50,000	24,50,000
C	40,00,000	10,00,000	2,00,000	8,00,000	32,00,000

It is possible to take a view that the remaining donations reflected in Column VI which are taxable at normal rates would be eligible for application of income and thereby, the benefit of exemption under section 11 would apply.

Illustration 11

The following trusts claim that anonymous donations received by them during the financial year 2017-18 are not liable to tax under section 115BBC:

(i) A charitable trust referred to in section 11 which applied the entire amount of anonymous donations for purposes of the trust during the relevant financial year.

(ii) A trust established wholly for religious purposes which applied 75% of the amount of anonymous donations for the purposes of the objects of the trust during the relevant financial year.

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Examine the validity of the claim made by the trusts.

Solution

(i) Section 115BBC provides for levy of tax @ 30% on anonymous donation received by, inter alia, charitable trusts or institutions referred to in section 11 in the following manner:

(a) the amount of income-tax calculated @30% on the aggregate of anonymous donations received in excess of 5% of the total donations received by the assessee or one lakh rupees, whichever is higher; and

(b) the amount of income-tax with which the assessee would have been chargeable had his total income been reduced by the aggregate of the anonymous donations received in excess of 5% of the total donations received by the assessee or Rs.1 lakh, as the case may be.

Further, section 13(7) provides that the exemption provisions contained in sections 11 and 12 shall not be applicable in respect of any anonymous donation liable to tax under section 115BBC. As such, application of the anonymous donations received by the charitable trust for charitable purposes does not confer any exemption from tax. Therefore, the claim for non-taxability under section 115BBC of anonymous donations received by the charitable trust is not valid in law.

However, a view may be taken that anonymous donation upto higher of 5% of total donations or Rs.1 lakh, which is taxable at normal rates would be eligible for application of income and thereby, the benefit of exemption under section 11 would apply.

(ii) Section 115BBC(2) provides that the provisions contained in section 115BBC(1) relating to the taxability of anonymous donations are not applicable to any trust or institution created or established wholly for religious purposes. As such, the trust established wholly for religious purposes is not liable to be taxed in respect of the anonymous donations received by it. Therefore, the claim made by the trust is valid in law. The application or non-application of such anonymous donation for the purposes of trust during the relevant financial year is not germane to the issue of taxability under section 115BBC.

Illustration 12

Explain in the context of provisions of the Act, whether the income derived during the year ended on 31.03.2018 in following case shall be subject to tax in the A.Y. 2018-19:

A political party, duly registered under section 29A of the Representation of the People Act, 1951, received rent of Rs.1,25,000 per month of one of its building let out to a bank from 01.06.2017.

Solution

Rent received by the political party from the bank is an income chargeable under the head "Income

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from house property". However, according to the provisions of section 13A, income from, inter alia, house property shall not be included in total income of a political party registered under section 29A of the Representation of the People Act, 1951, provided the political party fulfills the conditions as specified therein including furnishing a return of income for the previous year in accordance with the provisions of sub-section (4B) of section 139 on or before the due date under section 139. Therefore, if the stipulated conditions are fulfilled by the political party, rent of Rs.1,25,000 per month received by the registered political party from letting out of its building to a bank would not be included in its total income.

Illustration 13

The books of account maintained by a National Political Party registered with Election Commission for the year ended on 31.3.2018 discloses the following receipts:

		`
(a)	*Rent of property let out to a departmental store at Chennai*	*6,00,000*
(b)	*Interest on deposits other than banks*	*5,00,000*
(c)	*Cash contributions from 100 persons (who have secreted their names) of ` 3,000 each*	*3,00,000*
(d)	*Contribution @ ` 1,100 each from 1,000 members by cheque (recorded in books of account)*	*11,00,000*
(e)	*Net profit of cafeteria run in the premises at Delhi*	*3,00,000*

Compute the total income of the political party for the assessment year 2018-19, with reasons for inclusion or otherwise.

Solution

The total income of a political party registered with the Election Commission is to be computed as per section 13A under which the income derived from house property, income from other sources and income by way of voluntary contributions received from any person, on fulfilling of the conditions as mentioned thereunder are exempt from tax. In this case assuming that the National Political Party fulfills all the conditions mentioned thereunder, the income is computed as under:

Computation of total income of National Political Party

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	Particulars	`
(a)	The rent of the property of ` 6 lacs located at Chennai	Nil
(b)	The interest received on deposits of ` 5 lacs	Nil
(c)	Cash contributions given by 100 persons of ` 3,000 each by secreting their identities (not allowable, since cash contribution in excess of ` 2,000 not permissible)	3,00,000
(d)	The contribution of ` 1,100 each given by its members being recorded in the books	Nil
(e)	Net profit of cafeteria at Delhi	3,00,000
	Total Income	**6,00,000**

Note: It is presumed that the conditions regarding maintenance of books of account, audit, submission of report under section 29C of the Representation of the People Act, 1951 and filing of return of income under section 139(4B) are fulfilled by the political party.

EXERCISE

Question 1

A trust, unless created for "charitable purpose", does not qualify to claim exemption under Chapter III of the Act. In this context, explain the meaning of "charitable purpose" and examine whether the following objects constitute part of it:

(i) Rural reconstruction and upliftment of the masses through Cottage Industry.

(ii) Welfare of industrial workers with a stipulation that the workers of settlor of trust have got preference over othe

Answer

Section 2(15) defines “charitable purpose” to include relief of the poor, education, medical relief, yoga, 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. However, “advancement of any other object of general public utility” would not be a charitable purpose, if it involves carrying on of any activity in the nature of trade, commerce or business or, 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.

“Advancement of any other object of general public utility” would continue to be a “charitable purpose”, if the total receipt 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 20% of the total receipts of the trust in the previous year, and such activity is undertaken in the course of actual

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carrying out of such advancement of any other object of general public utility.

(i) The Supreme Court has, in Thiagarajar Charities vs. Addl. CIT (1997) 225 ITR 1010, observed that "cottage industry" is associated with the idea of a small, simple enterprise or industry in which employees work in their own houses or in a small place, gathered together for the purpose, using their own equipments and is usually found in rural areas or so carried on, by the poorer section of the society. In substance, the activity of rural reconstruction and upliftment of masses through cottage industry is to afford relief to the poor and consequently, it is for charitable purpose.

(1) The welfare of industrial workers with a stipulation that the workers of settlor of trust have preference over others would also constitute "charitable purpose" within the meaning of section 2(15). The Patna High Court has, in CIT v. Tata Steel Charitable Trust (1993) 203 ITR 764, observed that exemption under section 11(1) can be availed only if the following conditions are satisfied –the trust is created for a charitable purpose; and

(2) no part of the income of such trust enures or has been used or applied directly or indirectly for the benefit of any person referred to in section 13(3).

The list of persons contained in section 13(3) does not include employees of the settlor of the trust. Section 13(3)(d), which includes any relative of the author, can have no application because "relative" means a person connected by birth or marriage with another person. A person having relationship pursuant to a contract like that of an employer and an employee cannot be said to be a relative. The High Court concluded that it was immaterial that any employee of the settler of the trust had acquired any benefit out of the income of the trust as an ordinary member of the community. Therefore, the application of part of the income of the trust for the benefit of the employees of the settler cannot disentitle the trust from claiming exemption under section 11.

Question 2

How do you deal with the following situation? Give reasons for your answer.

Ramji Charitable Trust has filed return of income for the Assessment Year 2018-19 within the stipulated time under section 139(1) and applied only 50% of its income to specified purposes. It intends to accumulate the balance 35% of income to be spent in future yea While completing the assessment, the Assessing Officer disallowed the accumulated income of 35% and taxed the same on the ground that the trust has not made any application under section 11(2) along with return of income. Discuss the validity of the action of the Assessing Officer in this case.

Answer

Section 11(2) provides that a charitable trust has to apply 85% of its income to charitable purposes and where 85% of its income is not applied for such purposes, the trust may accumulate or set apart either the whole or part of its income for future application for such purposes in India. The requirement of the Act is that the trust has to make an application/intimation in the prescribed form, for accumulation of income, specifying the purpose and the period (not exceeding 5 years). The

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application should be filed or furnished before the assessing authority on or before the due date specified under section 139(1). Further, the money so set apart or accumulated should be invested/deposited in any one or more of these modes or forms specified under section 11(5).

Thus, this requirement of filing application is mandatory and without those particulars, the assessing authority cannot entertain the claim of the assessee under section 11. In case the statement in Form 10 is not submitted on or before the due date of filing return of income under section 139(1), then, the benefit of accumulation would not be available and such income would be taxable at the applicable rate. Further, the benefit of accumulation would also not be available if return of income is not furnished on or before the due date of filing of return of income under section 139(1). Therefore, the action of the Assessing Officer is correct.

Question 3

Ramji Charitable Trust, registered u/s 12AA and recognized u/s 80G of the Income-tax Act, 1961, was created for providing relief to disabled persons. It filed the return of income for the year ended 31/3/2018, declaring 'Nil' income. While completing the assessment, the Assessing Officer found that a large sum was donated to the corpus of another trust by the assessee i.e., Ramji Charitable Trust. The contention of the assessee was that such donation was made out of the permissible accumulation of income of past years upto 15% u/s 11(1)(a) of the Act.

The Assessing Officer added the donation so made and by invoking the Explanation to section 11(2), computed the taxable income of the assessee. Examine the validity of the action of the Assessing Officer, in this case.

Answer

As per the provisions of section 11(1)(a), accumulation upto 15% is permitted and no additional conditions are attached with such accumulation. It is an absolute exemption.

However, as per section 11(2), accumulation in excess of 15% is also allowed but subject to certain conditions mentioned therein. The provisions of section 11(2) are also subject to provisions of section 11(3)(d), which mentions that the amount accumulated in excess of 15% ;under section 11(2) cannot be donated to another trust. If it is so donated, it shall be deemed to be the income of the donor trust in the year of payment.

The provisions contained in section 11(3)(d), however, cannot be applied to the accumulations made under section 11(1)(a) i.e., accumulations upto 15%, in the absence of specific provisions in this regard.

It was so held by the Delhi High Court in DIT (Exemption) v. Bagri Foundation (2012) 344 ITR 193.

Explanation to section 11(2) merely provides that if donation is made out of past accumulations upto 15%, it cannot be treated as application of income for charitable purposes. This does not imply that such donations have to be added to compute total income, which is so in the case of donations out of accumulations in excess of 15% made under section 11(2).

Consequently, if the donations made by Ramji Charitable Trust to another charitable trust were out

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of past accumulations upto 15% under section 11(1)(a), the same would not be liable to be included in the total income. The action of the Assessing Officer in invoking the Explanation to section 11(2), to add such donations while computing the total income of the trust is, therefore, not valid.

Question 4

An institution operating for promotion of education claiming exemption under section 11 since 1994 furnishes the following data for the assessment year 2018-19:

S. No.	Particulars	Rs.in crores
(i)	Fees collected from students	14
(ii)	Construction of a new computer science laboratory	0.50
(iii)	Land acquired to be used as a cricket field for the students	2
(iv)	Amount earmarked and set apart for construction of an arts block within the next 4 yea	4

Compute the total income of the institution for the A.Y.2018-19.

Answer

Computation of total income of the institution for the A.Y. 2018-19

Particulars	Rs.(in crores)
Fees received	14.00
Less : 15% (exempt even if not spent for the objects of the institution)	2.10
	11.90
Less : Accumulated for specified purpose **(See Note 2)**	4.00
Balance to be spent	7.90
Actual amount spent on construction of computer science lab **(See Note 1)**	0.50
Actual amount spent on purchase of land for cricket field **(See Note 1)**	2.00
Total Income	**5.40**

Notes:

(1) The institution must utilise 85% of its income within the previous year for the objects of the institution. The institution can apply its income either for revenue expenditure or for capital expenditure provided the expenditure is incurred for promoting the objects of the institution. Land acquired and meant for use as cricket field for students is a capital expenditure incurred for promoting the objects of the institution and hence, eligible for deduction. Likewise, the amount

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spent on construction of computer science laboratory is also eligible for deduction.

(2) Section 11(2) provides that a trust/institution can accumulate or set apart its income for a specified purpose by furnishing statement in prescribed format to the concerned Assessing Officer. However, the period for which the funds can be accumulated cannot exceed 5 yea The amount so accumulated should be invested in the specified forms and modes. In this case, the institution has to furnish statement in Form 10 on or before the due date of filing return of income to the Assessing Officer, stating the purpose for which the income is being accumulated or set apart and the period for which the income is being accumulated or set apart, which shall, in no case, exceed five yea Further, the institution has to invest Rs.4 crore in the specified forms and modes.

Question 5

A public charitable trust registered under Section 12AA, for the previous year ending 31.3.2018, derived gross income of Rs.21 Lacs, which consists of the following:

		(Rs.in Lacs)
(a)	Income from properties held by trust (net)	10
(b)	Income (net) from business (incidental to main objects)	4
(c)	Voluntary contributions from public	7

The trust applied a sum of Rs.11.60 lacs towards charitable purposes during the year which includes repayment of loan taken for construction of orphanage Rs.3.60 lacs.

Determine the taxable income of the trust for the assessment year 2018-19.

Answer **Computation of taxable income of public charitable trust**

	Particulars	`
(i)	Income from property held under trust (net)	10,00,000
(ii)	Income (net) from business (incidental to main objects)	4,00,000
(iii)	Voluntary contributions from public	7,00,000
	Voluntary contribution made with a specific direction towards corpus are alone to be excluded under section 11(1)(d). In this case, there is no such direction and hence, included.	--
		21,00,000
	Less: 15% of the income eligible for retention / accumulation without any conditions	3,15,000
		17,85,000
	Less: Amount applied for the objects of the trust (i) Amount spent for charitable purposes (` 11,60,000 - ` 3,60,000) (ii) Repayment of loan for construction of orphan home	 8,00,000 3,60,000
	Taxable Income	**6,25,000**

Question 6

A charitable trust registered under section 12AA of the Income-tax Act, 1961 has, out of its income of Rs.3,90,000 for the year ending 31.3.2018 and sale proceeds of a capital asset, held by it for less than 24 months, amounting to Rs.9,60,000, purchased a building during the year ending 31.3.2018 for Rs.13,50,000. The capital asset was sold during the year ending 31.3.2018. The building is held only for charitable purposes. The trust claims that the purchase of the building amounts to application of its income for charitable purposes and that the capital gain arising on the sale of the capital asset is deemed to have been applied to charitable purposes. Is the claim made by the charitable trust valid in law?

Answer

Section 11(1)(a) stipulates that in order to avail exemption of income derived from property held under trust wholly for charitable or religious purposes, the trust is required to apply for charitable or religious purposes, 85% of its income from such property. In this case, the trust has earned income of Rs.3,90,000 for the year ended 31.3.2018. It has also earned short term capital gain from sale of capital asset for Rs.9,60,000. The trust had utilized the entire amount of Rs.13,50,000 for the purchase of a building meant for charitable purposes.

The Supreme Court, in S.RM. M. CT. M. Tiruppani Trust v. CIT (1998) 230 ITR 636, ruled that the assessee-trust, which applied its income for charitable purposes by purchasing a building for use as a hospital, was entitled to exemption under section 11(1) in respect of such income.

The ratio of the decision squarely applies to the case of the charitable trust in question. Therefore, the charitable trust is justified in claiming that the purchase of the building amounted to application of its income for charitable purposes.

Under section 11(1A), where the whole of the sale proceeds of a capital asset held by a charitable trust is utilised by it for acquiring another capital asset, the capital gain arising therefrom is deemed to have been applied to charitable purposes and would be exempt. Section 11(1A) does not make any distinction between a long-term capital asset and a short-term capital asset. The claim of the charitable trust to the effect that the capital gain is deemed to have been applied to charitable purposes is tenable in law.

Question 7

Work out, from the following particulars, the amount of capital gain which shall be deemed to have been applied for charitable or religious purpose arising out of sale of a capital asset utilized for the purposes of trust to the extent of 60%:

Particulars	`
Cost of transferred asset	2,40,000
Sale consideration	3,60,000
Cost of new asset purchased	3,00,000

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Answer

In this case, since the asset which is transferred is utilized for the purposes of the trust only to the extent of 60%, only the proportionate amount (i.e. 60%) of the capital gain would be regarded as having been applied for charitable or religious purposes.

As per section 11(1A), where a capital asset held under trust is transferred, and only a part of the net consideration is utilized for acquiring a new capital asset, only so much of the capital gain as is equal to the amount, if any, by which the amount so utilized exceeds the cost of the transferred asset shall be considered to have been applied for the objects of the trust.

In this case, only a part of the net consideration of Rs.3,60,000 is utilized for acquiring the new capital asset costing Rs.3,00,000. The amount utilized in acquiring the new asset (i.e. Rs.3,00,000) exceeds the cost of the transferred asset (i.e. Rs.2,40,000) by Rs.60,000.

Therefore, only 60% of (Rs.3,00,000 – Rs.2,40,000) = 60% of Rs.60,000 = Rs.36,000 is deemed to be applied for the objects of the trust.

Question 8

An electoral trust approved by the CBDT is not liable to income-tax in respect of voluntary contribution received and other income - Examine the correctness of the statement.

Answer

Section 13B provides exemption in respect of voluntary contribution received by an electoral trust approved by the CBDT in accordance with the scheme to be made by the Central Government.

Voluntary contribution received by an electoral trust would 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 surplus brought forward from any earlier yea Another condition for availing the benefit under this section is that the electoral trust should function in accordance with the rules framed by the Central Government.

It may be noted that the exemption under section 13B will be available only in respect of voluntary contribution received by an electoral trust. The exemption cannot be claimed in respect of any other income of the electoral trust.

Therefore, the given statement is not correct.

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SIGNIFICANT SELECT CASES

1. Where an institution engaged in imparting education incidentally makes profit, would it lead to an inference that it ceases to exist solely for educational purposes?

Queen's Educational Society v. CIT (2015) 372 ITR 699 (SC)

Facts of the case: The assessee, an educational institution, showed a net surplus of Rs.6.59 lakhs and Rs.7.83 lakhs, respectively, for the assessment years 2000-01 and 2001-02. Since it was established with the sole object of imparting education, it claimed exemption under section 10(23C)(iiiad). The Assessing Officer rejected the claim of exemption on the ground that the assessee has made profits and did not exist solely for educational purposes. The Commissioner (Appeals) allowed the assessee's claim and the Tribunal dismissed the Revenue's appeal holding that the assessee was engaged undoubtedly in imparting education and the profit was only incidental to the main object of spreading education. However, the High Court restored the order of the Assessing Officer on the reasoning that the institution made profit, year on year, and hence, was not eligible for tax exemption.

Supreme Court's Observations: The Supreme Court observed that the provisions of section 10(23C)(iiiad) provide for three requirements, namely,

(i) the education institution must exist solely for educational purposes;

(ii) it should not be for purposes of profit; and

(iii) the aggregate annual receipts of such institution should not exceed the amount as may be prescribed. Such monetary limit is Rs.1 crore as per Rule 2BC.

The Supreme Court concurred with the Tribunal's reasoning that profit is only incidental to the main object of spreading education. If there is no surplus arising out of the difference between receipts and outgoings, the trust will not be able to achieve the objectives. Any education institution cannot be run in rented premises for all the times and without necessary equipment and without paying to the staff engaged in imparting education. The assessee is not getting any financial aid/assistance from the Government or other philanthropic agency and, therefore, to achieve the objective, it has to raise its own funds. However, such surplus would not come within the ambit of denying exemption under section 10(23C)(iiiad).

Further, the Apex Court made reference to the tests culled out in its own decisions in the case of Addl. CIT v. Surat Art Silk Cloth Manufacturers Association [1980] 121 ITR 1, Aditanar Educational Institution v. Addl. CIT [1997] 224 ITR 310 and American Hotel and Lodging Association Educational Institute v. CBDT [2008] 301 ITR 86, which would apply for determining whether an educational institution exists solely for education purposes and not for purposes of profit.

The Apex Court, after analyzing the legal provisions and precedents, summed up the law common to section 10(23C)(iiiad)/(vi):

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(a) Where an educational institution carries on the activity of education primarily for educating persons, the fact that it makes a surplus does not lead to the conclusion that it ceases to exist solely for educational purposes and becomes an institution for the purpose of making profit;

(b) The predominant object test must be applied – the purpose of education should not be submerged by a profit making motive;

(c) A distinction must be drawn between the making of surplus and an institution being carried on "for profit". Merely because imparting of education results in making a profit, it cannot be inferred that it becomes an activity for profit;

(d) If after meeting expenditure, surplus arises incidentally from the activity carried on by the educational institution, it will not cease to be one existing solely for educational purposes; and

(e) The ultimate test is whether on an overall view of the matter in the concerned assessment year, the object is to make profit as opposed to educating persons.

Apex Court's Decision: Based on the above principles and tests, the Apex Court upheld the Tribunal's view that the assessee was engaged in imparting education and the profit was only incidental to the main object of spreading education. Hence, it satisfies the conditions laid down in section 10(23C)(iiiad) for claim of exemption thereunder.

2. Would imparting education/training in specialized field like communication, advertising etc. and awarding diplomas/certificates constitute an "educational purpose" for grant of exemption under section 10(23C)(vi)?

CIT v. St. Peter's Educational Society (2016) 385 ITR 66 (SC)

Facts of the case: The assessee-society registered under the Societies Registration Act, 1860 as well as under the provisions of the Bombay Public Trust Act, 1950 was engaged in imparting higher and specialized education. It imparted education in the field of communication including advertising and its related subjects. It was granted registration under section 12A of the Act originally.

The assessee later submitted an application for exemption under section 10(23C)(vi) and for which after calling for details, the CIT refused to grant exemption under section 10(23C)(vi). The reasons for refusal were (i) the society was not having education as the sole purpose; (ii) it is engaged in conducting coaching / training courses for and on behalf of industry, trade and commercial organizations; (iii) it is engaged in various social activities of general public utility; and (iv) it was not conducting educational courses as charitable activity but for the purpose of making profit.

High Court's view: The Court noted that the object clause of the society which indicated that the institution was awarding diplomas, certificates etc after providing training in

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communication, advertising and related subjects. The memorandum of the assessee showed that the fee collected shall not exceed the cost of training, hostel expenses etc and it is not precluded from subsidizing such costs. It observed that providing training to the individuals as well as those persons who have been sponsored by the companies to meet the needs of Indian industry and commerce, would not make the assessee-society as carrying on activity of service in relation to any trade, commerce and industry.

It held that teaching does not mean teaching the students only in the manner and method, the regular schools or colleges adopt to teach. In the progressive world, it is expected from certain institutions that they educate, teach and train persons so that those persons can compete with similar experts worldwide. It thus rejected the argument of the Revenue and held that providing latest information and training to persons to become super specialists in a particular field would still be treated as education.

Supreme Court's Observations: The Apex Court took note of the observations of the High Court and made reference to its own precedent in the case of Queen's Educational Society v. CIT (2015) 372 ITR 699 (SC) where it had summarized the legal position as under:

"The law common to sections 10(23C)(iiiad) and (vi) may be summed up as follows:

(i) Where an educational institution carries on the activity of education primarily for educating persons, the fact that it makes a surplus does not lead to the conclusion that it ceases to exist solely for educational purposes and becomes an institution for the purpose of making profit;

(ii) The predominant object test must be applied – the purpose of education should not be submerged by a profit making motive;

(iii) A distinction must be drawn between making of a surplus and the institution being carried on 'for profit'. No inference arises that merely because imparting education results in making a profit, it becomes an activity for profit;

(iv) If after meeting the expenditure, a surplus arises incidentally from the activity carried on by the educational institution, it will not cease to be one existing solely for educational purposes;

(v) The ultimate test is whether on an overall view of the matter in the concerned assessment year, the object is to make profit as opposed to educating persons".

The Apex Court, in Queen's Educational Society's case, noted the divergence of opinion among various High Courts on this issue. In that case, it had approved the decision of Delhi, Bombay and Punjab & Haryana High Courts and set aside the judgement of Uttarakhand High Court.

The Apex Court held that the correct tests for determining whether an institution exists solely for educational purposes and not for the purposes of profit were laid down in the Supreme

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Court decisions in CIT (Addl.) v. Surat Art Silk Mfg. Association (1980) 121 ITR 1; Aditanar Educational Institution v. Addl. CIT (1997) 224 ITR 310; and American Hotel & Lodging Assn. Educational Institute v. CBDT (2008) 301 ITR 86.

It further observed that the Thirteenth proviso to section 10(23C) is of great importance to the assessing authorities who must continuously monitor from assessment year to assessment year to know whether such institutions continues to apply their income and invest or deposit their funds in accordance with the law laid down. The activities of such institutions must be looked at carefully. If they are not genuine or are not being carried out in accordance with all or any of the conditions subject to which approval was given earlier, such approval and exemption must forthwith be withdrawn.

Supreme Court's Decision: Applying the rationale of the Supreme Court ruling in *Queen's Educational Society's* case, the Apex Court, in this case, held that the institution is established for the sole purpose of imparting education in a specialized field. The Supreme Court, thus, allowed the petition and set aside the order of the Chief Commissioner of Income-tax refusing exemption under section 10(23C)(vi).

Note: *Institutions engaged in providing specialized training in certain fields and awarding diplomas and certificates are also eligible for tax exemption in terms of section 10(23C)(vi). It is not mandatory for such institutions to impart education in formalized manner or conduct only recognized educational courses. Further, when corporates depute employees for gaining specialized knowledge, such imparting of knowledge by the institution would not mean that the institution is engaged in the activity of general public. Making of profit incidentally will not make the institution as existing for making profit. This is the jist of the above Supreme Court ruling.*

3. In a case where the charitable trust is deemed to be registered under section 12A due to non-disposal of application within the period of 6 months, as stipulated under section 12AA(2), from when would such deemed registration take effect?

CIT v. Society for the Promotion of Education (2016) 382 ITR 6 (SC)

Facts of the case: In the present case, the Allahabad High Court held that once an application for registration of the trust is made under section 12A and in case the same is not responded to within six months, the trust would be deemed to be registered under section 12AA. The High Court opined that non-consideration of the application for registration within the time fixed by the legal provision would lead to deemed grant of registration and there is no reason to make the assessee suffer merely because the Income Tax Department is not able to keep its officers under check and control so as to take timely decisions on the matter.

The Revenue appealed against this decision and raised an apprehension that since the date of application was February 24, 2003, the deemed registration would operate only after six months from the date of application.

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Supreme Court's Decision: The Apex Court clarified that deemed registration would commence only after 6 months from the date of application. Therefore, the registration of the application under section 12AA of the Income-tax Act, in the case of the assessee trust shall take effect from August 24, 2003.

Note:

This decision is based on the provisions of section 12A prior to insertion of clause (aa) in sub-section (1) of section 12A and sub-section (2) in section 12A by the Finance Act, 2007 with effect from 1st June, 2007. The position prior to the amendment by the Finance Act, 2007 was that an application for registration has to be made before the expiry of one year from the date of creation of the trust. However, where an application for registration was made thereafter, the exemption provisions under sections 11 and 12 would apply from the date of creation of the trust, if the Principal Commissioner or Commissioner, for reasons to be recorded in writing, is satisfied that the person in receipt of the income was prevented from making the application before the expiry of one year. If he is not so satisfied, the exemption would apply from 1st day of the financial year in which the application was made.

The Finance Act, 2007 has inserted sub-section (2) in section 12A to provide that where an application has been made on or after 01.06.2007, the provisions of section 11 and 12 shall apply in relation to the income of such trust from the assessment year immediately following the financial year in which **such application is made**.

In Society for the Promotion of Education's case, the Supreme Court has decided that the deemed registration would be effective only after six months from the date of application, in the sense, that it would not have retrospective application. The Supreme Court ruling assumes significance in the current context, since it affirms that non-consideration of application within the time period of six months from the end of the month in which application is received would tantamount to deemed registration. However, in the light of the current provisions of section 12A(2), the exemption provisions of sections 11 and 12 would apply in relation to the income of the trust from the assessment year immediately following the financial year in which such application is made, even though the effective date of deemed registration would be after expiry of the six month period as per the above Supreme Court ruling.

4. **Where a charitable trust applied for issuance of registration under section 12A within a short time span (nine months, in this case) after its formation, can registration be denied by the concerned authority on the ground that no charitable activity has been commenced by the trust?**

DIT (Exemptions) v. Meenakshi Amma Endowment Trust (2013) 354 ITR 219 (Kar.)

Facts of the case: In the present case, the assessee, being a trust, made an application under section 12A for issuance of registration within nine months of its formation. The registration authority issued a show cause notice to the assessee-trust to furnish its audited

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accounts as also material indicating the actual activities undertaken by the trust. In response to the said notice, the assessee-trust furnished the details, wherein it indicated that it has not yet commenced any charitable activity. The concerned registration authority, not being satisfied with the reply, refused to grant registration to the trust on the ground that it has not commenced any charitable activity.

Issue: The issue under consideration is whether registration under section 12AA can be denied on the ground of non-commencement of charitable activity, where an application for registration has been made within a short-time span after the formation of the trust.

High Court's Observations: On this issue, the Karnataka High Court opined that an application under section 12A for registration of the trust can be sought even within a week of its formation. The activities carried on by the trust are to be seen in case the registration is sought much later after formation of the trust.

The High Court further observed that, in this case, the corpus fund included contribution made by the trustees only, which indicated that the trustees were contributing the funds by themselves in a humble way and were intending to commence charitable activities. Also, it was not the Revenue's contention that the assessee-trust had collected lots of donations for the activities of the trust, by the time its application came up for consideration before them. When the application for registration was made, the trust, therefore, did not have sufficient funds for commencement of its activities.

High Court's Decision: The High Court observed that, with the money available with the trust, it cannot be expected to carry out activity of charity immediately. Consequently, in such a case, it cannot be concluded that the trust has not intended to do any activity of charity. In such a situation, the objects of the trust as mentioned in the trust deed have to be taken into consideration by the authorities for satisfying themselves about the genuineness of the trust and not the activities carried on by it. Later on, if it is found from the subsequent returns filed by the trust, that it is not carrying on any charitable activity, it would be open to the concerned authorities to withdraw the registration granted or cancel the registration as per the provisions of section 12AA(3).

5. In a case where properties bequeathed to a trust could not be transferred to it due to ongoing court litigation and pendency of probate proceedings, can violation of the provisions of section 11(5) be attracted?

DIT (Exemption) v. Khetri Trust (2014) 367 ITR 723 (Del)

Facts of the case: As per the 'will' of Late Raja Bahadur Sardar Singh, the entire property, including immovable property and shares in foreign companies, were bequeathed to the trust. However, the properties could not be transferred to or acquired by the trust because of ongoing litigation in the Court. In the probate proceedings, the 'will' was challenged and the probate proceedings are still pending.

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The trustees paid Rs.1,10,000 for raising a memorial for late Raja Bahadur Sardar Singh and the said amount was given to a business entity for this purpose, but due to the ongoing dispute, such project was not completed. The business entity, however, paid interest on the said amount. The Assessing Officer denied the benefit of exemption under section 11, on the ground that the asset held in the form of shares of foreign company and the advance given to business entity were contrary to the mandate of section 11(5) and thus, the condition specified in section 13(1)(d) has been violated.

Appellate Authorities' views: The Commissioner (Appeals) observed that the validity of the will has been challenged in the probate proceedings; therefore, till the 'will' is probated and affirmed as genuine, the trust would not acquire the legal right on the property for the purpose of Income-tax Act, 1961. In case the probate is denied, the properties would not devolve on the trust. The shares in foreign company were still in the name of the donor, Late Raja Bahadur Sardar Singh, and its acquisition by the trust is dependent upon the adjudication of the probate.

Further, with regard to the advance given to the business entity, the Commissioner (Appeals) found that the said amount cannot be treated as an investment which was covered and regulated by section 11(5), since the intent and purpose behind the payment was not investment.

These views of the Commissioner (Appeals) were confirmed by the Tribunal.

High Court's Decision: Based on the above factual findings, elucidated and affirmed by the Commissioner (Appeals) and the Tribunal, the High Court held that there was no violation of section 11(5) in this case.

6. Is the approval of Civil Court mandatory for amendment of trust deed, even in a case where the settler has given power to the trustees to alter the trust deed?

DIT (Exemptions) v. Ramoji Foundation (2014) 364 ITR 85 (AP)

Facts of the case: The settler gave power to the trustees to amend, alter, change or modify the objects of the trust deed with the approval of two-third majority. Such additional or altered object, however, must be of charitable nature falling within the definition thereof under the relevant provisions of the Income-tax Act, 1961. Based on these provisions of the trust deed and referring to the Supreme Court decision in CIT v. Kamla Town Trust (1996) 217 ITR 699, the Tribunal held that the trust deed can be amended without approaching the Civil Court. Therefore, the Tribunal directed the DIT (Exemptions) to grant registration to the assessee- trust under section 12AA on the basis of the amended trust deed.

Issue: The issue under consideration before the High Court is whether the Tribunal was correct in holding that the amendment to the trust deed can be made without approaching the Civil Court, on the basis of the decision in the case of Kamla Town Trust (Supra).

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High Court's Observations: The High Court observed that the power has been given to the trustees by the settler to amend the trust deed without approaching the Civil Court, provided all the conditions laid down by the settler are fulfilled. The sanction of Civil Court is required only when there is no such power. When the power has been specifically given to the trustees by the settler, no further power from the Civil Court is required.

The High Court made reference to the Kamla Town Trust's case and observed that it has not been stated anywhere in the Supreme Court's decision that in spite of the power given to them by settler to amend the trust deed, the trustees have to approach the Civil Court to get the trust sdeed rectified.

High Court's Decision: Accordingly, in this case, the High Court held that the Tribunal has correctly dealt with the matter and the trust deed amended by the trustees can be relied upon by the Revenue authorities for the purpose of granting registration under section 12AA.

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Illustration 1

Mr. Gavaskar sought voluntary retirement from a Government of India Undertaking and received compensation of ` 40 lacs on 31st January, 2018. He is planning to use the money as capital for a business dealership in electronic goods. The manufacturer of the product requires a security deposit of ` 15 lacs, which would carry interest at 8% p.a. Gavaskar's wife is a graduate and has worked as marketing manager in a multinational company for 15 years. She now looks for a change in employment. She is willing to join her husband in running the business. She expects an annual income of ` 5 lacs. Mr. Gavaskar would like to draw a monthly remuneration of ` 40,000 and also interest @10% p.a. on his capital in the business. Mr. Gavaskar has approached you for a tax efficient structure of the business.

Discuss the various issues, which are required to be considered for formulating your advice. Computation of income or tax liability is not required.

Solution

The selection of the form of organisation to carry on any business activity is essential in view of the differential tax rates prescribed under the Income-tax Act, 1961 and specific concessions and deductions available under the Act in respect of different entities. For the purpose of formulating advice as to the tax efficient structure of the business, it is necessary for the tax consultant to consider the following issues:

(i) In the case of sole proprietary concern, interest on capital and remuneration paid to the proprietor is not allowable as deduction under section 37(1) as the expenditure is of personal nature. On the other hand, in the case of partnership firm, both interest on capital and remuneration payable to partners are allowable under section 37(1) subject to the conditions and limits laid down in section 40(b). Remuneration and interest should however, be authorised by the instrument of partnership and paid in accordance with such instrument. Such interest and salary shall be taxable in the hands of partners to the extent the same is allowed as deduction in the hands of the firm under section 40(b). Interest to partners can be allowed upto 12% on simple interest basis, while the limit for allowability for partners' remuneration is based on book profit under section 40(b). As per section 40(b)(v), partners' remuneration shall be allowed to the extent of aggregate of -

  (a) On the first ` 3,00,000 of book profit or in case of loss – ` 1,50,000 or at the rate of 90% of book profits, whichever is more

  (b) On the balance of book profit – at the rate of 60%

(ii) Partner's share in the profits of firm is not taxed in the hands of the partners by virtue of section 10(2A).

(iii) If a proprietary concern is formed, the salary of Mrs. Gavaskar shall be allowed as deduction under section 37(1).

(iv) The possibility of invoking section 40A(2) cannot be ruled out as salary is payable to a relative, who is an interested person within the meaning of section 40A(2). However, it can be argued successfully that salary of ` 5 lacs is justified in view of her long experience as marketing manager of a multinational company and the fair market value of services to be rendered by her to the concern.

(v) An issue arises as to whether remuneration of Mrs. Gavaskar would be includible in the total

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income of Mr. Gavaskar. Under section 64(1)(ii), remuneration of the spouse of an individual working in a concern in which the individual is having a substantial interest shall be included in the total income of the individual. However, the clubbing provision does not apply if the spouse possesses technical or professional qualification and the income is solely attributable to the application of his or her technical or professional knowledge and experience. Further, technical or professional qualification would not necessarily mean the qualifications obtained by degree or diploma of any recognized body [Batta Kalyani vs. CIT (1985) 154 ITR 0059 (AP)]. The experience of Mrs. Gavaskar as a marketing manager in a multinational company for 15 years may reasonably be considered as a professional qualification for this purpose.

(vi) If Mrs. Gavaskar joins the proprietary concern or partnership concern of her husband as employee, remuneration of `5 lacs shall be taxed in her hands under the head "salary".

(vii) If she joins as partner in the business, remuneration shall be taxed in her hand as business income under section 28 to the extent such remuneration is allowed in the hands of the firm under section 40(b).

(viii) The tax rate applicable to an individual depends on the level of his/her income, whereas for partnership firms it is flat rate at 30%. Surcharge@12% would be attracted only if total income exceeds ` 1 crore. For individuals, the rate of tax is 5% on income exceeding ` 2.50 lakhs but not exceeding ` 5 lakhs, 20% for total income exceeding ` 5 lakhs but not exceeding ` 10 lakhs and @30% in respect of income exceeding ` 10 lakhs for the assessment year 2018-19. The surcharge for total income exceeding ` 50 lakhs but not exceeding `1 crore is 10% and for total income exceeding `1 crore is 15% of tax payable. Education cess@2% and Secondary and higher education cess@1% is attracted in both the cases.

Implementation of GAAR Provisions under the Income Tax Act, 1961

Clarifications on certain queries about implementation of GAAR [Circular No.7 of 2017 dated 27-1-2017]

The provisions of Chapter X-A of the Income Tax Act, 1961 relating to General Anti-Avoidance Rule will come into force from 1st April, 2017. Certain queries have been received by the Board about implementation of GAAR provisions. The Board constituted a Working Group in June, 2016 for this purpose. The Board has considered the comments of the Working Group and the following clarifications are issued:

Question no. 1: Will GAAR be invoked if SAAR applies?

Answer: It is internationally accepted that specific anti avoidance provisions may not address all situations of abuse and there is need for general anti-abuse provisions in the domestic legislation. The provisions of GAAR and SAAR can coexist and are applicable, as may be necessary, in the facts and circumstances of the case.

Question no. 2: Will GAAR be applied to deny treaty eligibility in a case where there is compliance with LOB test of the treaty?

Answer: Adoption of anti-abuse rules in tax treaties may not be sufficient to address all tax avoidance strategies and the same are required to be tackled through domestic anti-avoidance rules. If a case of avoidance is sufficiently addressed by LOB in the treaty, there shall not be an occasion to invoke GAAR.

Question no. 3: Will GAAR interplay with the right of the taxpayer to select or choose method of implementing a transaction?

Answer: GAAR will not interplay with the right of the taxpayer to select or choose method of implementing a transaction.

Question no. 4: Will GAAR provisions apply where the jurisdiction of the FPI is finalised based on non-tax commercial considerations and such FPI has issued P-notes referencing Indian securities? Further, will GAAR be invoked with a view to denying treaty eligibility to a Special Purpose Vehicle (SPV), either on the ground that it is located in a tax friendly jurisdiction or on the ground that it does not have its own premises or skilled professional on its own roll as employees.

Answer: For GAAR application, the issue, as may be arising regarding the choice of entity, location etc., has to be resolved on the basis of the main purpose and other conditions provided under section 96 of the Act. GAAR shall not be invoked merely on the ground that the entity is located in a tax efficient jurisdiction. If the jurisdiction of FPI is finalized based on non-tax commercial considerations and the main purpose of the arrangement is not to obtain tax benefit, GAAR will not apply.

Question no. 5: Will GAAR provisions apply to (i) any securities issued by way of bonus issuances so long as the original securities are acquired prior to 01 April, 2017 (ii) shares issued post 31 March, 2017, on conversion of Compulsorily Convertible Debentures, Compulsorily Convertible Preference Shares (CCPS), Foreign Currency Convertible Bonds (FCCBs), Global Depository Receipts (GDRs), acquired prior to 01 April, 2017; (iii) shares which are issued consequent to split up or consolidation of such grandfathered shareholding?

Answer: Grandfathering under Rule 10U(1)(d) will be available to investments made before 1st April 2017 in respect of instruments compulsorily convertible from one form to another, at terms finalized at the time of issue of such instruments. Shares brought into existence by way of split or consolidation of holdings, or by bonus issuances in respect of shares acquired prior to 1st April 2017 in the hands of the same investor would also be eligible for grandfathering under Rule 10U(1)(d) of the Income Tax Rules.

Question no. 6: The expression "investments" can cover investment in all forms of instrument - whether in an Indian Company or in a foreign company, so long as the disposal thereof may give rise to income chargeable to tax. Grandfathering should extend to all forms of investments including lease contracts (say, air craft leases) and loan arrangements, etc.

Answer: Grandfathering is available in respect of income from transfer of investments made before 1st April, 2017. As per Accounting Standards, 'investments' are assets held by an enterprise for earning income by way of dividends, interest, rentals and for capital appreciation. Lease contracts and loan arrangements are, by themselves, not 'investments' and hence grandfathering is not available.

Question no. 7: Will GAAR apply if arrangement held as permissible by Authority for Advance Ruling?

Answer: No. The AAR ruling is binding on the PCIT / CIT and the Income Tax Authorities subordinate to him in respect of the applicant.

Question no. 8: Will GAAR be invoked if arrangement is sanctioned by an authority such as the Court, National Company Law Tribunal or is in accordance with judicial precedents etc.?

Answer: Where the Court has explicitly and adequately considered the tax implication while sanctioning an arrangement, GAAR will not apply to such arrangement.

Question no. 9: Will a Fund claiming tax treaty benefits in one year and opting to be governed by the provisions of the Act in another year attract GAAR provisions? An example would be where a

Fund claims treaty benefits in respect of gains from derivatives in one year and in another year sets-off losses from derivatives transactions against gains from shares under the Act.

Answer: GAAR provisions are applicable to impermissible avoidance arrangements as under section 96. In so far as the admissibility of claim under treaty or domestic law in different years is concerned, it is not a matter to be decided through GAAR provisions.

Question no. 10: How will it be ensured that GAAR will be invoked in rare cases to deal with highly aggressive and artificially pre-ordained schemes and based on cogent evidence and not on the basis of interpretation difference?

Answer: The proposal to declare an arrangement as an impermissible avoidance arrangement under GAAR will be vetted first by the Principal Commissioner / Commissioner and at the second stage by an Approving Panel, headed by judge of a High Court. Thus, adequate safeguards are in place to ensure that GAAR is invoked only in deserving cases.

Question no. 11: Can GAAR lead to assessment of notional income or disallowance of real expenditure? Will GAAR provisions expand the scope of charging provisions or scope of taxable base and/or disallow the expenditure which is actually incurred and which otherwise is admissible having regard to diverse provisions of the Act?

Answer: If the arrangement is covered under section 96, then the arrangement will be disregarded by application of GAAR and necessary consequences will follow.

Question no. 12: A definite timeline may be provided such as 5 to 10 years of existence of the arrangement where GAAR provisions will not apply in terms of the provisions in this regard in section 97(4) of the IT Act.

Answer: Period of time for which an arrangement exists is only a relevant factor and not a sufficient factor under section 97(4) to determine whether an arrangement lacks commercial substance.

Question no. 13: It may be ensured that in practice, the consequences of a transaction being treated as an 'impermissible avoidance arrangement' are determined in a uniform, fair and rational basis. Compensating adjustments under section 98 of the Act should be done in a consistent and fair manner. It should be clarified that if a particular consequence is applied in the hands of one of the participants, there would be corresponding adjustment in the hands of another participant.

Answer: Adequate procedural safeguards are in place to ensure that GAAR is invoked in a uniform, fair and rational manner. In the event of a particular consequence being applied in the hands of one of the participants as a result of GAAR, corresponding adjustment in the hands of another participant will not be made. GAAR is an anti-avoidance provision with deterrent consequences and corresponding tax adjustments across different taxpayers could militate against deterrence.

Question no. 14: Tax benefit of INR 3 crores as defined in section 102(10) may be calculated in respect of each arrangement and each taxpayer and for each relevant assessment year separately. For evaluating the main purpose to be obtaining of tax benefit, the review should extend to tax consequences across territories. The tax impact of INR 3 crores should be

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considered after taking into account impact to all the parties to the arrangement i.e. on a net basis and not on a gross basis (i.e. impact in the hands of one or few parties selectively).

Answer: *The application of the tax laws is jurisdiction specific and hence what can be seen and examined is the Tax Benefit' enjoyed in Indian jurisdiction due to the 'arrangement or part of the arrangement'. Further, such benefit is assessment year specific. Further, GAAR is with respect to an arrangement or part of the arrangement and therefore limit of Rs. 3 crores cannot be read in respect of a single taxpayer only.*

Question no. 15: *Will a contrary view be taken in subsequent years if arrangement held to be permissible in an earlier year?*

Answer: *If the PCIT/Approving Panel has held the arrangement to be permissible in one year and facts and circumstances remain the same, as per the principle of consistency, GAAR will not be invoked for that arrangement in a subsequent year.*

Question no. 16: *No penalty proceedings should be initiated pursuant to additions made under GAAR at least for the initial 5 years.*

Answer: *Levy of penalty depends on facts and circumstances of the case and is not automatic. No blanket exemption for a period of five years from penalty provisions is available under law. The assessee, may at his option, apply for benefit u/s 273A if he satisfies conditions prescribed therein.*

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EXERCISE

Question 1

Distinguish between Tax planning and Tax Evasion

Answer

Tax planning is carried out within the framework of law by availing the deductions and exemptions permitted by law and thereby minimizing tax liability. Tax planning is an arrangement by which full advantage is taken of the concessions and benefits conferred by the statute, without violation of legal provisions. Tax evasion on the other hand is an attempt to reduce tax liability by dubious or artificial methods or downright fraud. It is illegal and denies the State its legitimate share of tax.

Question 2

Specify with reason, whether the following acts can be considered as (i) Tax planning; or (ii) Tax management; or (iii) Tax evasion.

(i) Mr. P deposits ` 1,00,000 in PPF account so as to reduce his total income from ` 3,40,000 to ` 2,40,000.

(ii) SQL Ltd. maintains register of tax deduction at source effected by it to enable timely compliance.

(iii) An individual tax payer making tax saver deposit of ` 1,00,000 in a nationalised bank.

(iv) A partnership firm obtaining declaration from lenders/depositors in Form No. 15G/15H and forwarding the same to income-tax authorities.

(v) A company installed an air-conditioner costing ` 75,000 at the residence of a director as per terms of his appointment but treats it as fitted in quality control section in the factory. This is with the objective to treat it as plant for the purpose of computing depreciation.

(vi) RR Ltd. issued a credit note for ` 80,000 as brokerage payable to Mr. Ramana who is the son of the managing director of the company. The purpose is to increase the total income of Mr. Ramana from ` 4,00,000 to ` 4,80,000 and reduce the income of RR Ltd. correspondingly.

(vii) A company remitted provident fund contribution of both its own contribution and employees' contribution on monthly basis before due date.

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Answer

Tax Planning / Tax Management / Tax Evasion

	Answer	Reason
1.	Tax planning	Depositing money in PPF and claiming deduction under section 80C is as per the provisions of law.
2.	Tax management	Maintaining register of payments subject to TDS helps in complying with the obligations under the Income-tax Act, 1961.
3.	Tax planning	Making a tax saver deposit of ` 1,00,000 in a nationalized bank for claiming deduction under section 80C by an individual is a permitted tax planning measure under the provisions of income-tax law.
4.	Tax management	Obtaining declaration from lenders/depositors in Form No. 15G/15H by a partnership firm and forwarding the same to Income-tax authorities is in the nature of compliance of statutory obligation under the Income-tax Act, 1961.
5.	Tax evasion	An air conditioner fitted at the residence of a director as per the terms of his appointment would be a furniture qualifying for depreciation@10%, whereas an air conditioner fitted in a factory would be a plant qualifying for a higher depreciation@15%. The wrong treatment unjustifiably increases the amount of depreciation and consequently, reduces profit and consequent tax liability. Treatment of air-conditioner fitted at the residence of a director as a plant fitted at the factory would tantamount to furnishing of false particulars with an attempt to evade tax.
6.	Tax evasion	Issuance of a credit note for ` 80,000 by RR Ltd. as brokerage payable to Mr. Ramana, the son of the Managing Director, to increase his total income from ` 4 lakh to ` 4.80 lakh and to correspondingly reduce the company's total income is a method of reducing the tax liability of the company by recording a fictitious transaction. The company is liable to tax at a flat rate of 30% whereas Mr. Ramana is liable to pay tax @ 5% above the basic exemption limit of ` 2,50,000, since his total income does not exceed ` 5,00,000. Further, Mr. Ramana would also eligible for rebate of ` 2,500 under section 87A if total income does not exceed ` 3,50,000. Reducing tax liability by recording a fictitious transaction would tantamount to tax evasion.

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7.	Tax management	Remitting of own contribution to provident fund and employees contribution to provident fund on a monthly basis before due date is proper compliance of the statutory obligations.

Question 3

Examine the doctrine of form and substance in the context of tax planning.

Answer

The following are certain principles enunciated by the Courts on the question as to whether it is the form or substance of a transaction, which will prevail in income-tax matters:

(i) **Form of transaction is to be considered in case of genuine transactions -** It is well settled that when a transaction is arranged in one form known to law, it will attract tax liability whereas, if it is entered into in another form which is equally lawful, it may not. Therefore, in considering whether a transaction attracts tax or not, the form of the transaction put through is to be considered and not the substance. **However, this rule applies only to genuine transactions.** [CIT v. Motor and General Stores (P) Ltd. v. CIT (1967) 66 ITR 692(AP). Moreover, with General Anti Avoidance Rules coming into force with effect from A.Y.2017-18,

(ii) **True legal relation is the crucial element for taxability** - It is open for the authorities to pierce the corporate veil and look behind the legal facade at the reality of the transaction. The taxing authority is entitled as well as bound to determine the true legal relation resulting from a transaction. The true legal relation arising from a transaction alone determines the taxability of a receipt arising from the transaction [CIT v. B.M. Kharwar (1969) 72 ITR 603 (SC)]

(iii) Substance (i.e. actual nature of expense) is relevant and not the form –

(a) In the case of an expenditure, the mere fact that the payment is made under an agreement does not preclude the department from enquiring into the actual nature of the payment [Swadeshi Cotton Mills Co. Ltd. v. CIT (1967) 63 ITR 57(SC)].

(b) In order to determine whether a particular item of expenditure is of revenue or capital nature, the substance and not merely the form should be looked into. [Assam Bengal Cement Co. Ltd. v. CIT (1955) 27 ITR 34 (SC)].

Question 4

(a) The merger of a loss making company with a profit making one results in losses setting off profits, a lower net profit and lower tax liability for the merged company. Would the losses be disallowed by applying GAAR?

(b) In the above facts, let us presume, the profit making company merges with a loss making one. This results in losses setting off profits, a lower net profit and lower tax liability for both companies taken together. Can this be examined under GAAR?

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Answer

(a) As regards setting off of losses, the provisions relating to merger and amalgamation already contain specific anti-avoidance safeguards. Therefore, GAAR would not be invoked when SAAR is applicable.

(b) In case of merger of a profit-making company with loss making company, there is no specific anti-avoidance safeguards. However, since such merger would be under the order of High Court, GAAR cannot be invoked as it falls in the negative list (as recommended) for invoking GAAR as mentioned in guidelines.

Question 5

A choice is made by a company by acquiring an asset on lease over outright purchase. The company claims deduction for lease rentals in case of acquisition through lease rather than depreciation as in the case of purchase of the asset. Would the lease rent payment, being higher than the depreciation, be disallowed as expense under GAAR?

Answer

GAAR provisions would not apply in this case as the taxpayer merely makes a selection out of the options available to him.

Question 6

Indco incorporates Subco in a NTJ with equity of US$100. Subco has no reserves; it gives a loan of US$100 to Indco at the rate of 10% p.a. which is utilized for business purposes. Indco claims deduction of interest payable to Subco from the profit of business. There is no other activity in Subco. Can GAAR be invoked in such a case?

Answer

The main purpose of the arrangement is to obtain interest deduction in the hands of Indco and thereby tax benefit. There is no commercial substance in establishing Subco since without it there is no effect on the business risk of Indco or any change in the cash flow (apart from the tax benefit). Moreover, it is a case of round tripping which means a case of deemed lack of commercial substance. Hence, it would be treated as an impermissible avoidance arrangement.

Consequently, in the case of Indco, interest payment would be disallowed by disregarding Subco. No corresponding relief would be allowed in the case of Subco by way of refund of taxes withheld, if any.

Question 7

(a) An Indian company, X Ltd., is a closely held company and it is a subsidiary of company Y Ltd. incorporated in country C1. X Ltd. was regularly distributing dividends but stopped distributing

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dividends from 1.4.2003, the date when dividend distribution tax was introduced in India. X Ltd. allowed its reserves to grow by not paying out dividends. As a result, no DDT was paid by the company. Subsequently, buyback of shares was offered by X Ltd. to its shareholder company Y Ltd.

Y Ltd. paid taxes on the capital gains arising on buyback of shares at the applicable rate. Can GAAR be invoked on the ground that there is a deferral of tax liability by X Ltd., the Indian company?

(b) In the above case (a), let us presume, there is a DTAA between India and Country C1 which provides that capital gains arising in India to a resident of country C1 shall not be taxed in India provided that the resident incurs $200,000 annually as operating expenditure. The shareholder Y Ltd. incurs an operating expenditure above that limit and is entitled to the treaty benefit. Y Ltd. therefore does not pay any tax on capital gains.

Can GAAR be invoked on the ground that accumulation of profits by company X Ltd. and subsequent buyback is an arrangement mainly to obtain tax benefit?

Answer

(a) Whether to pay dividend to its shareholder, or buy back its shares or issue bonus shares out of the accumulated reserves is a business choice of a company. Further, at what point of time a company makes such a choice is its strategic policy decision. Such decisions cannot be questioned under GAAR.

(b) Payment of dividend to its shareholder or buy back of its shares or issuing bonus shares out of the accumulated reserves is a business choice of a company, which a company is entitled to exercise at any point of time. It should be interpreted as incidental that the shareholder is entitled to a treaty benefit which exempts capital gains, but it is subject to SAAR (i.e. Limitation of Benefit clause). The decision of X Ltd. cannot be questioned under GAAR.

Question 8

A foreign bank J Ltd.'s branch in India arranges loan for an Indian borrower from another branch of J located in a third country. The loan is later assigned to J's subsidiary in country F 3. The India-F3 Treaty provides no source based withholding tax on interest to a bank carrying out bona-fide business. This, therefore, results in no withholding tax on interest payment out of India.

Answer

The above arrangement of finalizing the loan from one country and assigning it to another country has been made mainly to avoid withholding tax provisions on the basis that there is no withholding provision on interest earned by F3 residents under the India-F3 treaty. There is a tainted element being abuse of the treaty and thus may be treated as an impermissible avoidance arrangement. The Revenue may invoke GAAR with regard to this arrangement.

Question 9

Company X borrowed money from Company Y and used it to buy shares in three 100% subsidiary companies of X. Though the fair market value per share was ` 100, X paid ` 600. The amount received by the said subsidiary companies was transferred back to another company connected to Y. The said shares were sold by X for ` 100/5 each and a short-term capital loss was claimed. This was set off against short-term capital gains from other sources. All the companies are Indian

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companies. Can GAAR be invoked?

Answer

By the above arrangement, the tax payer has obtained a tax benefit and created rights or obligations which are not ordinarily created between persons dealing at arm's length. Since transactions of purchase and sale of shares of a closely held company at a price other than the fair market value are covered under section 56 of the Act, GAAR may not be invoked as section 56, being SAAR, is applicable. However, if SAAR is not applicable considering the limited scope of section 56 to the shares of closely held companies only, then GAAR may be invoked.

Question 10

M/s Global Architects Inc is a company incorporated in country F1. It is engaged in the business of providing architectural design services all over the world. It receives an offer from Lovely Resorts Pvt Ltd, an Indian company, for design and development of resorts all over India.

India-F1 tax treaty provides that architectural services are technical services and payment for the same to a company may be taxed in India. However, if such professional services are provided by a firm or individual, then payment for such services are taxable only if the firm has a fixed base in India or stay of partners/ employees in India exceed 180 days.

M/s Global Architects Inc forms a partnership firm with a third party (director of the company) having only a nominal share in the F1. The firm enters into an agreement to carry out the services in India. The company seconded its trained manpower to the firm.

Thus, the partnership firm claimed the treaty benefit and no tax was paid in India. Can such an arrangement be examined under GAAR?

Answer

It is obvious that there was no commercial necessity to create a separate firm except to obtain the tax benefit. The firm was only on paper as the manpower was drawn from the company. The firm did not have any commercial substance. Moreover, it is a case of treaty abuse. Hence, GAAR may be invoked to disregard the firm and tax payment for architectural services as fee for technical services. However, the rate of tax on such payment shall be as applicable under the treaty, if more beneficial.

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Question 11

An Indian holding company Holdco borrows ` 10 crore for acquisition of shares of Subco which then became subsidiary of Holdco. Holdco and Subco amalgamate so that the interest payable on the monies borrowed to acquire the shares can be deducted in computing the income from the business of the amalgamated company.

Answer

The borrowing by Holdco followed by the amalgamation by Subco is not abusive and GAAR would not apply in the case of merger which is carried out under the orders of High Court.

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Illustration 1

LL Limited paid leave travel facility to its employees and considered exemption under section 10(5), based on the self-declaration furnished by the employees. The Assessing Officer held that the company as an employer ought to have verified the genuineness of the claim of exemption by obtaining from them, the proof of actual expenditure incurred by availing leave travel facility. Accordingly, the Assessing Officer treated the assessee company as assessee in default. Decide the correctness of action.

Solution

Section 192 casts liability on the employer to deduct tax at source from the salary paid to its employees.

In this case, the employer has paid leave travel concession / facility to its employees and the said concession / facility would be eligible for exemption subject to the conditions laid down in section 10(5) read with Rule 2B of the Income-tax Rules, 1962.

Section 192(2D) casts responsibility on the person responsible for paying any income chargeable under the head 'Salaries' to obtain from the assessee, the evidence or proof or particulars of prescribed claims under the provisions of the Act in the prescribed form and manner for the purposes of –

(1) estimating income of the assesses; or

(2) computing tax deductible under section 192(1).

Rule 26C of the Income-tax Rules, 1962 mandates a salaried assessee claiming, inter alia, leave travel concession or assistance to furnish evidence of expenditure incurred in relation thereto to the person responsible for making such for payment under section 192(1), for the purpose of estimating his income for computing the tax deductible under section 192.

Thus, the action of the Assessing Officer is correct in law.

Illustration 2

Mr. Sharma, an employee of M/s. ABC Ltd. since 10-04-2014 resigned on 31-03-2018 and withdrewRs.60,000 being the balance in his EPF account. State with reasons whether the provisions of Chapter XVII-B are attracted and if so, what is the net amount receivable by the payee, Mr. Sharma?

Solution

As per section 192A,in a case where the accumulated balance due to an employee participating in a recognized provident fund is includible in his total income owing to the provisions of Rule 8 of Part A of the Fourth Schedule not being applicable, the trustees of the Employees Provident Fund Scheme, 1952 or any person authorised under the scheme to make payment of accumulated balance due to employees are required to deduct income-tax@10% at the time of payment of accumulated balance due to the employee. Tax deduction at source has to be made only if the amount of such payment or aggregate amount of such payment of the payee is Rs.50,000 or more.

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Rule 8 of Part A of the Fourth Schedule, inter alia, provides that only if an employee has rendered continuous service of five years or more with the employer, then accumulated balance in a recognized provident fund payable to an employee would be excluded from the total income of that employee.

In the present case, Mr. Sharma has withdrawn an amount exceeding Rs.50,000 on his resignation after rendering a continuous service of four years with M/s. ABC Ltd. Therefore, tax has to be deducted at source@10% under section 192A on Rs.60,000, being the amount withdrawn on his resignation without rendering continuous service of a period of five years with M/s. ABC Ltd.

The net amount receivable by Mr. Sharma is Rs.54,000 [i.e., Rs.60,000 – Rs.6,000, being tax deducted at source].

Note – It is assumed that Mr. Sharma has furnished his permanent account number (PAN) to the person responsible for deducting tax at source. Otherwise, tax would be deductible at the maximum marginal rate. It may be noted that with effect from 1.6.2015 such employee can furnish declaration in Form No.15G for non-deduction of tax at source under section 192A by virtue of section 197A(1A).

Illustration 3

Examine the TDS implications under section 194A in the cases mentioned hereunder –

(i) On 1.10.2017, Mr. Harish made a six-month fixed deposit of Rs.10 lakh @9% p.a. with ABC Co-operative Bank. The fixed deposit matures on 31.3.2018.

(ii) On 1.6.2017, Mr. Ganesh made three nine month fixed deposits of Rs.1 lakh each carrying interest@9% with Dwarka Branch, Janakpuri Branch and Rohini Branch of XYZ Bank, a bank which has adopted CBS. The fixed deposits mature on 15.2.2018.

(iii) On 1.4.2017, Mr. Rajesh started a 1 year recurring deposit of Rs.20,000 per month@8% p.a. with PQR Bank. The recurring deposit matures on 31.3.2018.

Solution

(i) ABC Co-operative Bank has to deduct tax at source@10% on the interest of Rs.45,000 (9% × Rs.10 lakh × ½) under section 194A. The tax deductible at source under section 194A from such interest is, therefore, Rs.4,500.

(ii) XYZ Bank has to deduct tax at source@10% under section 194A, since the aggregate interest on fixed deposit with the three branches of the bank is Rs.20,250 [1,00,000 × 3 × 9% × 9/12], which exceeds the threshold limit of Rs.10,000. Since XYZ Bank has adopted CBS, the aggregate interest credited/paid by all branches has to be considered. Since the aggregate interest of Rs.20,250 exceeds the threshold limit of Rs.10,000, tax has to be deducted@10% under section 194A.

(iii) Tax has to be deducted under section 194A by PQR Bank on the interest of Rs.10,400 falling due on recurring deposit on 31.3.2018 to Mr. Rajesh, since –

(1) "recurring deposit" is included in the definition of "time deposit"; and

(2) such interest exceeds the threshold limit of Rs.10,000.

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DT QUESTION BANK BY YNB

Illustration 4

Maya Bank credited Rs.73,50,000 towards interest on the deposits in a separate account for macro-monitoring purposes by using Core-branch Banking Solutions (CBS) software. No tax was deducted at source in respect of interest on deposits so credited even where the interest in respect of some depositors exceeded the limit of Rs.10,000.

The Assessing Officer disallowed 30% of interest expenditure, where the interest on time deposits credited exceeded the limit of Rs.10,000 and also levied penalty under section 271C.

Decide the correctness of action of the Assessing Officer.

Solution

The Explanation below section 194A(1) provides that where any income by way of interest other than interest on securities 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 and provisions of section 194A, shall, thus, apply.

However, the CBDT has, vide Circular No.3/2010 dated 2.3.2010, clarified that Explanation to section 194A will not 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.

Since no constructive credit to the depositor's / payee's account takes place while calculating interest on daily / 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 the financial year or at periodic intervals as per practice of the bank or as per the depositor's or payee's requirement or on maturity or on encashment of time deposit, whichever event takes place earlier and wherever the aggregate amount of interest income credited or paid or likely to be credited or paid during the financial year by the bank exceeds the limits specified in section 194A i.e., Rs.10,000.

In view of the above, the action of the Assessing Officer in disallowing the interest expenditure credited in a separate account for macro monitoring purpose is not valid and consequent initiation of penalty proceedings under section 271C is not tenable in law.

Illustration 5

Mr. Govind won the first prize in a lottery ticket and the prize was a Maruti car worth Rs.5 lacs. What is the procedure to be adopted before handing over the Maruti Car to Mr. Govind?

Solution

Section 194B provides that the person responsible for paying to any person, any income by way of winnings from any lottery or crossword puzzle, card game or any other game of any sort and the amount of winning exceeds Rs.10,000,tax shall be deducted at source @ 30%.

However, in case where the winning is wholly in kind, the person responsible for paying the prize shall before releasing the winning, ensure that the tax has been paid in respect of such winning.

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The Karnataka High Court in the case of CIT v. Hindustan Lever Ltd. (2014) 361 ITR 1 has held that where the winnings are wholly in kind, the responsibility cast under section 194B is to ensure that the tax is paid by the winner of the prize before the prize is released in his favour. In this regard, the CBDT Circular No.763 dated 18/2/1998 clarifies that the person responsible for paying the winnings shall, before releasing such winnings, ensure that the tax is paid by the winner. He can do so, for example, by collecting from the winner a sum equal to the tax deductible at source on the winnings in kind, before releasing the winnings. For this purpose, the value of the winnings in kind shall be taken as the cost incurred by the payer in acquiring the said winnings in kind.

Therefore, in this case since the entire winning is in kind, it must be ensured that the sum equal to the tax deductible at source (i.e., Rs.1,50,000, being @ 30% of Rs.5 lacs) is paid by Mr. Govind, before the car is released in his favour. This can be done by collecting Rs.1,50,000 from Mr. Govind before releasing the Maruti car to him and remitting the said sum to the Government account or verifying the tax payment by the winner and thereafter releasing the prize.

Illustration 6

ABC Ltd. makes the following payments to Mr. X, a contractor, for contract work during the P.Y.2017-18–

Rs.20,000 on 1.5.2017

Rs.25,000 on 1.8.2017

Rs.28,000 on 1.12.2017

On 1.3.2018, a payment of Rs.30,000 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 Rs.30,000. However, since the aggregate amount paid to Mr. X during the P.Y.2017-18 exceeds Rs.1,00,000 (on account of the last payment of Rs.30,000, due on 1.3.2018, taking the total from Rs.73,000 to Rs.1,03,000), the TDS provisions under section 194C would get attracted. Tax has to be deducted@1% on the entire amount of Rs.1,03,000 from the last payment of Rs.30,000 and the balance of Rs.28,970 (i.e., Rs.30,000 – Rs.1,030) has to be paid to Mr. X.

(5) **Definition of work**

Illustration 7

Bharathi Cements Ltd. purchased jute bags from Raj Kumar & Co. The latter has to supply the jute bags with the logo and address of the assessee, printed on it. From 01.09.2017 to 20.03.2018, the value of jute bags supplied is Rs.8,00,000, for which the invoice has been raised on 20.03.2018. While effecting the payment for the same, is the assessee bound to deduct tax at source,

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assuming that the value of the printing component involved is Rs.1,10,000. You are informed that the assessee has not sold any material to Raj Kumar & Co. and that the latter has to manufacture the jute bags in its plant using raw materials purchased by it from outsiders.

Solution

As per the definition under section 194C, "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. This is regardless of the quantum of expenditure incurred towards printing or processing comprised in the bill amount. The problem clearly states that Raj Kumar & Co. has to manufacture the jute bags using raw

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materials purchased from outsiders and that the assessee Bharathi Cements Ltd has not sold any material to them. Therefore, in this case, it is a contract of sale. Hence, the provisions of section 194C are not **attracted and no liability to deduct tax at source would arise.**

Illustration 8

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DT QUESTION BANK BY YNB

Alap Ltd. has made following payments on various dates in financial year 2017-18 to Vilambit Ltd. towards work done under different contracts:

Contract Number	Date of payment	Amount (Rs.)
1.	5.5.2017	20,000
2.	6.6.2017	15,000
3.	8.8.2017	25,000
4.	10.12.2017	25,000
5.	29.01.2018	17,000

Alap Ltd. claims that it is not liable for deduction of tax at source under section 194C. Examine the correctness of the claim made by the company. What would be the position if the value of the contract no. 5 is Rs.14,000 only and there was no further contract during the year?

Solution

As per section 194C(5), tax has 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 Rs.30,000 in a single payment or Rs.1,00,000 in aggregate during the financial year.

Therefore, in the given case, even though the value of each individual contract does not exceed Rs.30,000, the aggregate amount exceeds Rs.1,00,000. Hence, Alap Ltd's contention is not correct and tax is required to be deducted at source on the whole amount of Rs.1,02,000 from the last payment of Rs.17,000 towards Contract No.5 on account of which the aggregate amount exceeded Rs.1,00,000.

However, no tax deduction is to be made if the value of the last contract is Rs.14,000 as the aggregate amount in such case would only be Rs.99,000, which is below the aggregate monetary limit ofRs.Rs.1,00,000.

Illustration 9

Examine the applicability of the provisions for tax deduction at source under section 194DA in the following cases -

(i) Mr. X, a resident, is due to receive Rs.4.50 lakhs on 31.3.2018, towards maturity proceeds of LIC policy taken on 1.4.2015, for which the sum assured is Rs.4 lakhs and the annual premium is Rs.1,25,000.

(ii) Mr. Y, a resident, is due to receive Rs.2.75 lakhs on 31.3.2018 on LIC policy taken on 31.3.2012, for which the sum assured is Rs.2.50 lakhs and the annual premium is Rs.35,000.

(iii) Mr. Z, a resident, is due to receive Rs.95,000 on 1.10.2017 towards maturity proceeds of LIC policy taken on 1.10.2012 for which the sum assured is Rs.90,000 and the annual premium was Rs.15,000.

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Solution

(i) Since the annual premium exceeds 10% of sum assured in respect of a policy taken after 31.3.2012, the maturity proceeds of Rs.4.50 lakhs are not exempt under section 10(10D) in the hands of Mr. X. Therefore, tax is required to be deducted@1% under section 194DA on the maturity proceeds of Rs.4.50 lakhs payable to Mr. X.

(ii) Since the annual premium is less than 20% of sum assured in respect of a policy taken before 1.4.2012, the sum of Rs.2.75 lakhs due to Mr. Y would be exempt under section 10(10D) in his hands. Hence, no tax is required to be deducted at source under section 194DA on such sum payable to Mr. Y.

(iii) Even though the annual premium exceeds 10% of sum assured in respect of a policy taken after 31.3.2012, and consequently, the maturity proceeds of Rs.95,000 would not be exempt under section 10(10D) in the hands of Mr. Z, the tax deduction provisions under section 194DA are not attracted since the maturity proceeds are less than Rs.1 lakh.

Illustration 10

Calculate the amount of tax to be deducted at source (TDS) on payment made to Ricky Ponting, an Australian cricketer, by a newspaper for contribution of articles Rs.25,000.

Solution

Under section 194E, the person responsible for payment of any amount to a non-resident sportsman for contribution of articles relating to any game or sport in India in a newspaper shall deduct tax @ 20%. Further, since Ricky Ponting is a non-resident, education cess@2% and secondary and higher education cess@1% on TDS would also be added.

Therefore, tax to be deducted = Rs.25,000 x 20.60% = Rs.5,150.

Illustration 11

B. Airways Ltd. sold tickets to the travel agents in India at a minimum fixed commercial price. The agents were permitted to sell the tickets at a higher price but not exceeding the maximum published price. Commission at the rate of 9% of minimum fixed commercial price was deducted under section 194H by the company. The Assessing Officer contended that the liability for tax deduction at source is attracted on the difference between the minimum fixed commercial price and the maximum published price by treating it as "additional special commission" in the hands of the agents.

Is the contention of Assessing Officer tenable in law?

Solution

As per the provisions of section 194H, a person is liable to deduct tax at source at the time of credit or payment of commission to any resident, whichever is earlier.

In the present case, B. Airways Ltd. correctly deducted tax at source under section 194H from the commission@9% of the minimum fixed commercial price paid to the travel agents, who were allowed to sell the air tickets at any price higher than the minimum fixed commercial price subject to a maximum published price. However, the Assessing Officer contented that the airline company was

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required to deduct tax at source on the difference between the minimum fixed commercial price and the maximum published price by treating it as "additional special commission" in the hands of the agents.

The facts of the case are similar to the case of CIT v. Qatar Airways (2011) 332 ITR 253, where the Bombay High Court held that the difference between the maximum published price and the minimum fixed commercial price cannot be taken as "additional special commission" in the hands of the agents. This is because the maximum published price is the maximum price and the airline company has granted permission to the agents to sell the tickets at a price lower than the maximum published price. Further, the airline company would have no information about the exact rate at which the tickets were ultimately sold by its agents. In order to deduct tax at source on the difference between actual sale price and minimum fixed commercial price, the exact income in the hands of the agents must be ascertainable by the airline company. However, it is not so ascertainable in this case, since the agents are given discretion to sell the tickets at any rate between the minimum fixed commercial price and the maximum published price. **It would be impracticable and unreasonable to expect the airline company to get a feedback from its numerous agents in respect of the price at which the tickets were sold by them.**

Applying the rationale of the above case to the case on hand, B. Airways Ltd. is not liable to deduct tax at source under section 194H on the difference between the maximum published price and the minimum fixed commercial price, even though the amount earned by the agent over and above the minimum fixed commercial price is taxable as income in their hands.

Therefore, the contention of the Assessing Officer is not tenable in law.

Illustration 12

Discuss the following issues in the context of the provisions of the Income-tax Act, 1961, with specific reference to clarification given by the Central Board of Direct Taxes -

(i) Moon TV, a television channel, made payment of Rs.50 lakhs to a production house for production of programme for telecasting as per the specifications given by the channel. The copyright of the programme is also transferred to Moon TV. Would such payment be liable for tax deduction at source under section 194C? Discuss.

Also, examine whether the provisions of tax deduction at source under section 194C would be attracted if the payment was made by Moon TV for acquisition of telecasting rights of the content already produced by the production house.

(ii) Mudra Adco Ltd., an advertising company, has retained a sum of Rs.15 lakhs, towards charges for procuring and canvassing advertisements, from payment of Rs.1 crore due to Cloud TV, a television channel, and remitted the balance amount of Rs.85 lakhs to the television channel. Would the provisions of tax deduction at source under section 194H be attracted on the sum of Rs.15 lakhs retained by the advertising company?

Solution

(i) In this case, since the programme is produced by the production house as per the

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specifications given by Moon TV, a television channel, and the copyright is also transferred to the television channel, the same falls within the scope of definition of the term 'work' under section 194C. Therefore, the payment of Rs.50 lakhs made by Moon TV to the production house would be subject to tax deduction at source under section 194C.

If, however, the payment was made by Moon TV for acquisition of telecasting rights of the content already produced by the production house, there is no contract for ''carrying out any work", as required in section 194C(1). Therefore, such payment would not be liable for tax deduction at source under section 194C.

(ii) The issue of whether fees/charges taken or retained by advertising companies from media companies for canvasing/booking advertisements (typically 15% of the billing) is 'commission' or 'discount' to attract the provisions of tax deduction at source has been clarified by the CBDT vide its Circular No.5/2016 dated 29.2.2016.

The relationship between the media company and the advertising agency is that of a 'principal-to-principal' and, therefore, not liable for TDS under section 194H. In view of the same, the CBDT has clarified that no liability to deduct tax is attracted on payments made by television channels to the advertising agency for booking or procuring of or canvassing for advertisements.

Accordingly, in view of the clarification given by CBDT, no tax is deductible at source on the amount of Rs.15 lakhs retained by Mudra Adco Ltd., the advertising company, from payment due to Cloud TV, a television channel.

Illustration 13

Mahanadi Limited has taken a 3,000 sq. ft. flat on rent from Yamuna Limited to set up its Branch Office. The rent payable to Yamuna Limited for the flat is Rs.60,000 per month plus applicable service tax. Mahanadi Limited wishes to know whether tax is required to be deducted at source under section 194-I from gross amount of rent including service tax. Give your advice.

Solution

The CBDT Circular No.4/2008 dated 15.04.2008 has clarified that service tax paid by the tenant does not partake the nature of income of the landlord. The landlord only acts as a collecting agency of the 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.

Note - In respect of payments other than rent, the CBDT has, vide Circular No.1/2014 dated 13.01.2014, clarified that wherever in terms of the agreement/contract between the payer and the payee, the service tax component comprised in the amount payable to a resident is indicated separately, tax shall be deducted at source on the amount paid/payable without including the service tax component.

Illustration 14

ABC Ltd. took on sub-lease a building from J, an individual, with effect from 1.9.2017 on a rent of Rs.20,000 per month. It also took on hire machinery from J with effect from 1.10.2017 on hire

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charges of Rs.15,000 per month. ABC Ltd. entered into two separate agreements with J for sub-lease of building and hiring of machinery. The rent of building and hire charges of machinery for the financial year 2017-18 were Rs.1,40,000 and Rs.90,000, respectively, which were credited by ABC Ltd. to the account of J in its books of account on 31.3.2018. Examine the obligation of ABC Ltd. with regard to deduction of tax at source in respect of the rent and hire charges.

Solution

As per section 194-I dealing with deduction of tax at source from payment of rent, the rate of TDS applicable is 2% for machinery hire charges and 10% for building lease rent. The scope of the section includes within its ambit, rent for machinery, plant and equipment. Tax is required to be deducted at source from payment of rent, by whatever name called, under any lease, sub- lease, tenancy or any other agreement or arrangement for the use of building and machinery, irrespective of whether such assets are owned or not by the payee.

The limit of Rs.1,80,000 for tax deduction at source will apply to the aggregate rent of all the assets. Even if two separate agreements are entered into, one for sub-lease of building and another for hiring of machinery, rent and hire charges under the two agreements have to be aggregated for the purpose of application of the threshold limit of Rs.1,80,000. In this case, since the payment for rent and hire charges credited to the account of J, the payee, aggregates to Rs.2,30,000 (Rs.1,40,000 + Rs.90,000), tax is deductible at source under section 194-I. Tax is deductible@10% on Rs.1,40,000 (rent of building) and @2% on Rs.90,000 (hire charges of machinery).

Illustration 15

Mr. X sold his house property in Bangalore as well as his rural agricultural land for a consideration of Rs.60 lakh and Rs.15 lakh, respectively, to Mr. Y on 1.8.2017. He has purchased the house property and the land in the year 2016 for Rs.40 lakh and Rs.10 lakh, respectively. The stamp duty value on the date of transfer, i.e., 1.8.2017, is Rs.85 lakh and Rs.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)	**Tax implications in the hands of Mr. X**
	As per section 50C, the stamp duty value of house property (i.e. Rs.85 lakh) would be deemed to be the full value of consideration arising on transfer of property. Therefore, Rs.45 lakh (i.e., Rs.85 lakh – Rs.40 lakh, being the purchase price) would be taxable as short-term capital gains in the A.Y.2018-19. 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)	**Tax implications in the hands of Mr.Y**

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	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)(x), if such difference exceeds Rs.50,000. Therefore, in this case Rs.25 lakh (Rs.85 lakh – Rs.60 lakh) would be taxable in the hands of Mr. Y under section 56(2)(x). Since agricultural land is not a capital asset, the provisions of section 56(2)(x) are not attracted in respect of receipt of agricultural land for inadequate consideration, since the
	definition of "property" under section 56(2)(x) includes only capital assets specified thereunder.
(iii)	**TDS implications in the hands of Mr. Y**
	Since the sale consideration of house property exceeds Rs.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 Rs.60,000, being 1% of Rs.60 lakh. TDS provisions under section 194-IA are not attracted in respect of transfer of rural agricultural land.

Illustration 16

Mr. X, a salaried individual, pays rent of Rs.55,000 per month to Mr. Y from June, 2017. Is he required to deduct tax at source? If so, when is he required to deduct tax? Also, compute the amount of tax to be deducted at source.

Would your answer change if Mr. X vacated the premises on 31st December, 2017? Also, what would be your answer if Mr. Y does not provide his PAN to Mr. X?

Solution

Since Mr. X pays rent exceeding Rs.50,000 per month in the F.Y. 2017-18, he is liable to deduct tax at source @5% of such rent for F.Y. 2017-18 under section 194-IB. Thus, Rs.27,500 [Rs.55,000 x 5% x 10] has to be deducted from rent payable for March, 2018.

If Mr. X vacated the premises in December, 2017, then tax of Rs.19,250 [Rs.55,000 x 5% x 7] has to be deducted from rent payable for December, 2017.

In case Mr. Y does not provide his PAN to Mr. X, tax would be deductible @20%, instead of 5%.

In case 1 above, this would amount to Rs.1,10,000 [Rs.55,000 x 20% x 10] but the same has to be restricted to Rs.55,000, being rent for March, 2018.

In case 2 above, this would amount to Rs.77,000 [Rs.55,000 x 20% x 7] but the same has to be restricted to Rs.55,000, being rent for December, 2017.

Illustration 17

XYZ Ltd. makes a payment of Rs.28,000 to Mr. Ganesh on 2.8.2017 towards fees for professional services and another payment of Rs.25,000 to him on the same date towards fees for technical services. Discuss whether TDS provisions under section 194J are attracted.

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Solution

TDS provisions under section 194J would not get attracted, since the limit of Rs.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.2017-18.

(4) **Non-applicability of TDS under section 194J**

Illustration 18

East Bengal Club, a renowned football club, has engaged Raghu, a resident in India, as its coach at a remuneration of Rs.6 lacs per annum. The club wants to know from you whether it is liable to deduct tax at source from such remuneration.

Solution

Section 194J requires deduction of tax at source @10% from the amount credited or paid by way of fees for professional services, where such amount or aggregate of such amounts credited or paid to a person exceeds Rs.30,000 in a financial year. As per Explanation (a) to section 194J, professional services includes services rendered by a person in the course of carrying on such other profession as is notified by the CBDT for the purposes of section 194J.

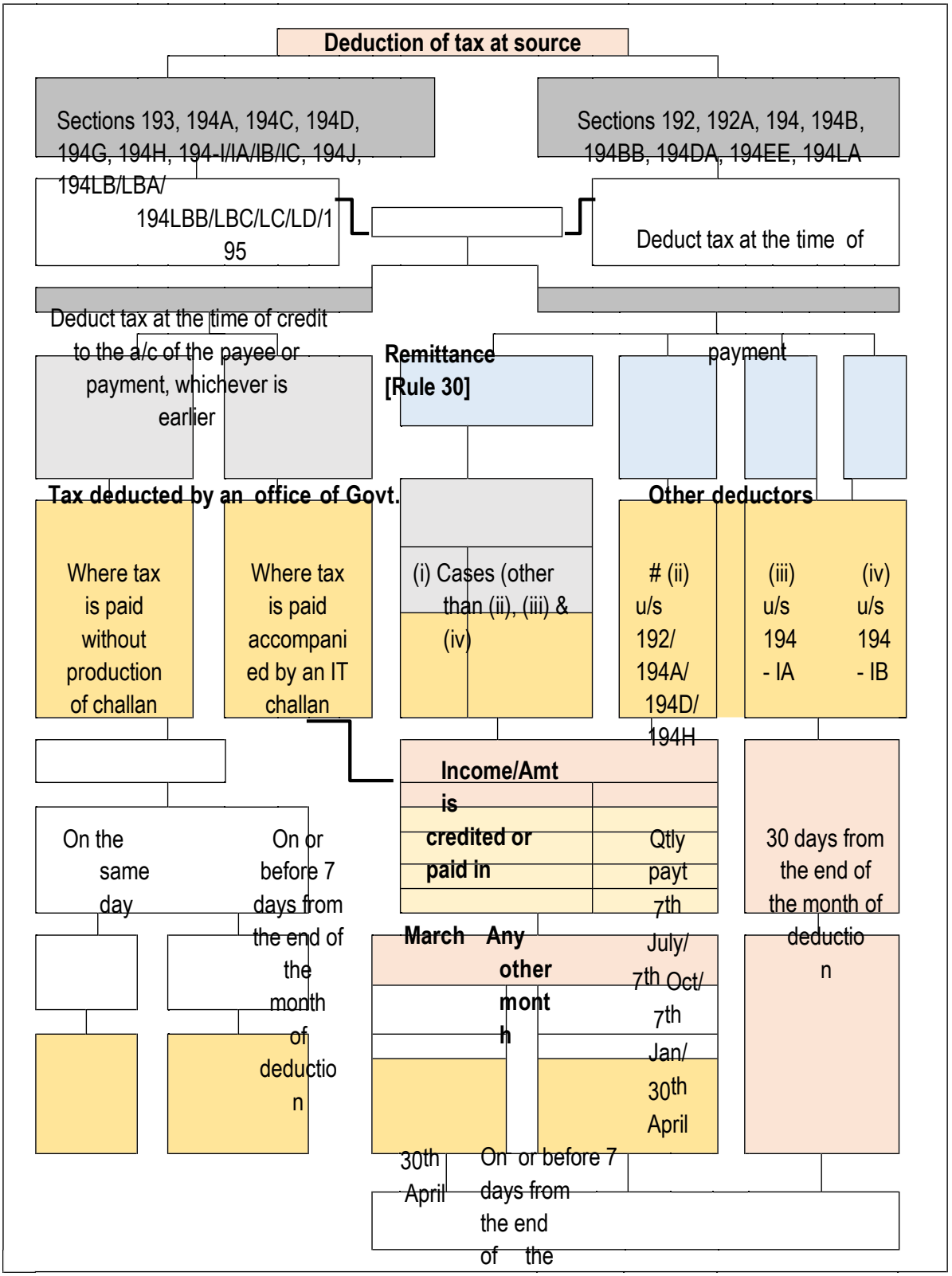
Accordingly, the CBDT has, vide Notification No.88 dated 21.8.2008, in exercise of the powers conferred by clause (a) of the Explanation to section 194J notified the services rendered by coaches and trainers in relation to the sports activities as professional services for the purposes of section 194J.

Therefore, the club is liable to deduct tax at source under section 194J from the remuneration payable to the Coach, Raghu.

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Sl. No.	Date of ending of the quarter of the financial year	Due date
1.	30th June	31st July of the financial year
2.	30th September	31st October of the financial year
3.	31st December	31st January of the financial year
4.	31st March	31st May of the financial year immediately following the financial year in which the deduction is made.

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PAO/TO/CDDO

Submit Statement in Form 24G to agency authorised by PDIT (Sys)

Furnishing Stt of TDS [Rule 31A] [Form 24Q/26Q/27Q]

Qtr ending	Due date
30th June	31st July
30th Sep	31st Oct
31st Dec	31st Jan
31St March	31st May

Rule 31A - Furnish Challan-cum-stt in Form 26QB/26QC with 30 days from the end of the month of deduction

Furnishing Certificate of TDS [Rule 31]

Where Stt relates to March	Where Stt relates to other months	Deduction u/s 192	Deduction under other sections	Certificate to the payee
On or before 30th April	On or before 15 days from end of the relevant month	**Form 16 16A** By 15th June of the immediately following F.Y.	**Form** Within 15 days from the due date for furnishing TDS statement	within 15 days from the above due date in Form 16B/16C

Rule 31 - Furnish

In special cases, the A.O. may, with the prior approval of the JC, permit quarterly payment of TDS

Rule 31AB - DGIT (Sys) to deliver stt of TDS in Form 26AS to the deductee by 31st July of following year

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Illustration 20

An amount of Rs.40,000 was paid to Mr. X on 1.7.2017 towards fees for professional services without deduction of tax at source. Subsequently, another payment of Rs.50,000 was due to Mr. X on 15.2.2018, from which tax@10% (amounting to Rs.9,000) on the entire amount of Rs.90,000 was deducted. However, this tax of Rs.9,000 was deposited only on 22.6.2018. Compute the interest chargeable under section 201(1A).

Solution

Interest under section 201(1A) would be computed as follows –

Particulars	Rs.
1% on tax deductible but not deducted i.e., 1% on Rs.4,000 for 8 months	320
1½% on tax deducted but not deposited i.e. 1½% on Rs.9,000 for 4 months	540
	860

(i) Such interest should be paid before furnishing the statements in accordance with section 200(3).

(ii) 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.

(iii) 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.

(5) **Time limit for deeming a person to be an assessee-in-default for failure to deduct tax at source**

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DT QUESTION BANK BY YNB

Illustration 21

The Assessing Officer issued a notice of demand under section 156 to Mr. X on 1.10.2016 for payment of Rs.15 lakhs towards his income-tax liability for the A.Y.2015-16, requiring him to pay the said amount within 30 days.

(a) Is he required to issue fresh notice of demand and if so, for what amount, in the following two cases (each case has to be considered independently) –

(i) If the tax demand is reduced to Rs.12 lakhs by the Commissioner (Appeals) by issue of order under section 250;

(ii) If the tax demand is increased to Rs.20 lakhs by the Appellate Tribunal, by issue of an order under section 254.

(b) How would the interest liability under section 220(2) be calculated if the tax demand is reduced to Rs.12 lakhs by the Commissioner (Appeals) by issue of order under section 250 and subsequently increased to Rs.15 lakhs by the Appellate Tribunal by way of issue of order under section 254?

Solution

(a) (i) No fresh notice of demand is required to be served on Mr. X. The Assessing Officer is only required to give an intimation of the fact of reduction of demand to Rs.12 lakhs to Mr. X. The proceedings initiated on the basis of the original notice of demand may be continued in relation to the reduced amount of Rs.12 lakhs from the stage at which such proceedings stood immediately before disposal of appeal.

(ii) A fresh notice of demand has to be given only in respect of Rs.5 lakhs, being the amount of enhancement. Any proceedings in relation to Rs.15 lakhs covered by the original notice of demand served upon Mr. X may be continued from the stage at which such proceedings stood immediately before disposal of appeal.

(b) The interest under section 220(2) has to be paid on Rs.15 lakhs @1% per month or part of the month comprised in the period commencing from 1.11.2016 and ending with the date on which the amount is paid, assuming that Mr. X has not paid any interest so far.

EXERCISE

Question 1

Mr. Madhusudan is regular in deducting tax at source and depositing the same. In respect of the quarter ended 31st December, 2017 a sum of Rs.80,000 was deducted at source from the contractors. The statement of tax deducted at source under section 200 was filed on 23rd March, 2018 for the quarter ended 31.12.2017.

(i) Is there any delay on the part of Mr. Madhusudan in filing the statement of TDS?

(ii) If the answer to (i) above is in the affirmative, how much amount can be levied on Mr.

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Madhusudan for such default under section 234E?

(iii) Is there any remedy available to him for reduction/waiver of the levy?

Answer

(i) Yes, there has been a delay on the part of Mr. Madhusudan in filing the statement of TDS.

As per section 200(3) read with Rule 31A, the statement of tax deducted at source for the quarter ended 31st December, 2017 has to be filed on or before 31st January, 2018. However, the same has been filed only on 23rd March, 2018. Hence, there has been a 51 days delay on the part of Mr. Madhusudan in filing the statement of TDS.

(ii) As per section 234E of the Income-tax Act, 1961, where a person fails to file deliver or cause to be delivered the statement of tax deducted at source within the prescribed time, then, he shall be liable to pay, by way of fee, a sum of Rs.200 for every day during which the failure continues.

The amount of fee shall not, however, exceed the amount of tax deductible.

In this case, since Mr. Madhusudhan has delayed filing the statement of TDS by 51 days, he would be liable to pay a fee of Rs.10,200 (Rs.200 x 51 days) under section 234E. The said fee does not exceed the tax deductible (Rs.80,000, in this case).

(iii) The CBDT is empowered to issue general or special orders, whether by way of relaxation of any of the provisions of sections 139, 143, 144, 147 etc. or otherwise, in respect of any class of incomes or class of cases. The CBDT may issue such order(s) from time to time if it considers expedient so to do, for the purpose of proper and efficient management of the work of assessment and collection of revenue. Section 234E is included in the list of sections in respect of which the CBDT is empowered to issue order for relaxation of the provisions of the Act.

Hence, the remedy available to Mr. Madhusudhan is that he can file an application to the CBDT under section 119 and seek waiver/reduction of the penalty levied/leviable under section 234E.

Question 2

Smt. Vijaya, proprietor of Lakshmi Enterprises, made turnover of Rs.210 lakhs during the previous year 2016-17. Her turnover for the year ended 31-3-2018 was Rs.90 lakhs.

Decide whether provisions relating to deduction of tax at source are attracted for the following payments made during the financial year 2017-18:

(i) Purchase commission paid to one agent Rs.25,000 on 13.6.2017 towards purchases made during the year.

(ii) Payments to Civil engineer of Rs.5,00,000 for construction of residential house for self use.

Answer

Since Smt. Vijaya's turnover was Rs.210 lakhs in the immediately preceding financial year (i.e., F.Y.2016-17), she is liable to deduct tax at source in the P.Y.2017-18, irrespective of her turnover

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being only Rs.90 lakhs in the F.Y.2017-18.

(i) Tax@5% has to be deducted under section 194H in respect of purchase commission of Rs.25,000 to an agent for purchases made during the year, since the same exceeds the threshold limit of Rs.15,000 for non-deduction of tax at source thereunder.

(ii) Tax has to be deducted under section 194C in case of payment to resident contractors. The rate of tax is 1% if the payee is an individual or HUF and 2% in case of payees, other than individuals and HUFs.

However, as per section 194C(4), no individual or Hindu undivided family shall be liable to deduct income tax on the sum credited or paid to the account of the contractor where such sum is credited or paid exclusively for personal purposes of such individual or any member of the Hindu undivided family.

In this case, since Smt. Vijaya, an individual, makes payment of Rs.5 lakh to a civil engineer for construction of residential house for self use, she is not liable to deduct tax at source under section 194C from such sum.

Question 3

What is the rate at which the tax is either to be deducted or collected under the provisions of the Act in the following cases?

(i) A partnership firm making sales of timber which was procured and obtained under a forest lease.

(ii) Payment of income on investments in the securities to the Foreign Institutional Investor.

(iii) A nationalized bank receiving professional services from a registered society made provision on 31-03-2018 of an amount of Rs.25 lacs against the service charges bills to be received.

(iv) Payment of Rs. 5 lacs made to Mr. Phelps who is an athlete by a manufacturer of a swim wear for brand ambassador.

Answer

Applicable Rate of TDS/TCS

Situation	TCS/TDS	Rate	Note
(i) Partnership firm selling timber obtained under forest lease	TCS	2.5%	1
(ii) Payment of income on investments in the securities to the Foreign Institutional Investors In case the securities are Government securities	TDS	20.6% 5.15%	2
(iii) Professional services rendered by a registered society to a nationalised bank	TDS	10%	3

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(iv) Payment by a manufacturer of swim wear to its brand ambassador Mr. Phelps, an athlete	TDS		4
If Mr. Phelps is a resident		10%	
If Mr. Phelps is a non-resident		20.6%	

otes:

(1) As per section 206C(1), tax has to be collected at source@2½% by the partnership firm, being a seller, at the time of debiting of the amount payable by the buyer to the account of the buyer or at the time of receipt of such amount, whichever is earlier.

(2) As per section 196D, tax has to be deducted at source @ 20.6% (20% plus cess@3%) by any person who is responsible for paying to a Foreign Institutional Investor, any income by way of interest on securities at the time of credit of such income to the account of the payee or at the time of payment of such income, whichever is earlier.

Alternatively, if the said securities are assumed to be government securities, tax is deductible@5.15% (i.e., 5% plus cess@3%) under section 194LD.

(3) Tax has to be deducted at source@10% under section 194J, by the nationalized bank at the time of credit of fees for professional services to the account of the registered society (i.e., on 31.3.2018), even though payment is to be made after that date.

(4) Tax has to be deducted at source@10% under section 194J[4] in respect of income of Rs.5 lacs

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[4]CBDT Circular No.715 dated 8.8.1995

paid to Mr. Phelps, athlete, for advertisement, on the inherent presumption that Mr. Phelps is a resident.

Alternatively, if Mr. Phelps is assumed to be a non-resident, who is not a citizen of India, tax has to be deducted at source@20.6% (20% plus cess 3%) under section 194E in respect of income of Rs.5 lacs paid to Mr. Phelps, an athlete, for advertisement referred under section 115BBA.

Question 4

Examine the liability for tax deduction at source in the following cases for the assessment year 2018-19:

(i) Wings Ltd. has paid amount of Rs.15 lacs during the year ended 31-3-2018 to Airports Authority of India towards landing and parking charges.

(ii) Omega Ltd., an event management company, organized a concert of international artists in India. In this connection, it engaged the services of an overseas agent Mr. John from UK to bring artists to India. He contacted the artists and negotiated with them for performance in India in terms of the authority given by the company. He did not take part in event organized in India.

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The company made the payment of commission equivalent to Rs. 1 lac to the overseas agent.

(iii) Ramesh gave a building on sub-lease to Mac Ltd. with effect from 1-7-2017 on a rent of Rs.15,000 per month. The company also took on hire machinery from Ramesh with effect from 1-11-2017 on hire charges of Rs.10,000 per month. The rent of building and hire charges of machinery for the year 2017-18 were credited by the company to the account of Ramesh in its books of account on 31-3-2018.

(iv) Rs.2,45,000 paid to Mr. X on 01-02-2018 by Karnataka State Government on compulsory acquisition of his urban land. What would be your answer if the land is agricultural land?

Answer

(i) **TDS on landing and parking charges:** The landing and parking charges which are fixed by the Airports Authority of India are not merely for the "use of the land". These charges are also for services and facilities offered in connection with the aircraft operation at the airport which include providing of air traffic services, ground safety services, aeronautical communication facilities, installation and maintenance of navigational aids and meteorological services at the airport [Japan Airlines Co. Ltd. v. CIT / CIT v. Singapore Airlines Ltd. (2015) 377 ITR 372 (SC)]. Thus, tax is not deductible under section 194I which provides deduction of tax for payment in the nature of rent.

Hence, tax is deductible @2% under section 194C by the airline company, Wings Ltd., on payment of Rs.15 lacs made towards landing and parking charges to the Airports Authority of India for the previous year 2017-18.

(ii) **TDS on services of overseas agent outside India:** An overseas agent of an Indian company operates in his own country and no part of his income accrues or arises in India. His commission is usually remitted directly to him and is, therefore, not received by him or on his behalf in India. The commission paid to the non-resident agent for services rendered outside India is, thus, not chargeable to tax in India.

Since commission income for contacting and negotiating with artists by Mr. John, a non- resident, who remains outside India is not subject to tax in India, consequently, there is no liability for deduction of tax at source. It is assumed that the commission equivalent to Rs.1 lakh was remitted to Mr. John outside India.

(iii) **TDS on rent for building and machinery:** Tax is deductible on rent under section 194-I, if the aggregate amount of rental income paid or credited to a person exceeds Rs.1,80,000. Rent includes payment for use of, inter alia, building and machinery.

The aggregate payment made by Mac Ltd. to Ramesh towards rent in P.Y.2017-18 is Rs.1,85,000 (i.e., Rs.1,35,000 for building and Rs.50,000 for machinery). Hence, Mac Ltd. has to deduct tax@10% on rent paid for building and tax@2% on rent paid for machinery.

(iv) **TDS on compensation for compulsory acquisition:** Tax is deductible at source @10% under section 194LA, where payment is made to a resident as compensation or enhanced compensation on compulsory acquisition of any immovable property (other than agricultural land).

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However, no tax deduction is required if the aggregate payments in a year does not exceed Rs.2,50,000.

Therefore, no tax is required to be deducted at source on payment of Rs.2,45,000 to Mr. X, since the aggregate payment does not exceed Rs.2,50,000.

Since the definition of immovable property specifically excludes agricultural land, no tax is deductible at source on compensation paid for compulsory acquisition of agricultural land.

Question 5

Examine whether tax has to be deducted at source under the provisions of the Income-tax Act, 1961 in the following situations, which have taken place during the year ended 31-3-2018:

(i) M/s. Jiva & Co., a partnership firm, pays a sum of Rs.43,000 as interest on loan borrowed from an Indian branch of a foreign bank.

(ii) Above firm has paid Rs.12,000 as interest on capital to partner Mr. A, a resident in India, and Rs.24,000 as interest on capital to partner Mr. B, a non-resident.

(iii) The above firm paid Rs.50,000 being share of profit of partner Mr. B, a non-resident

Answer

(i) Section 194A requires deduction of tax on any income by way of interest, other than interest on securities, credited or paid to a resident, at the rates in force.

However, it specifically excludes from its scope, income credited or paid to any banking company to which the Banking Regulation Act, 1949 applies.

An Indian branch of a foreign bank, transacting the business of banking in India, is a banking company to which the Banking Regulation Act, 1949 applies. Therefore, interest payment to such bank will not attract tax deduction under section 194A.

Consequently, no tax is required to be deducted at source under section 194A on interest of Rs.43,000 paid by M/s. Jiva & Co., a partnership firm, on loan borrowed from an Indian branch of a foreign bank.

(ii) Section 194A requiring deduction of tax at source on any income by way of interest, other than interest on securities, credited or paid to a resident, excludes from its scope, income credited or paid by a firm to its partner. Therefore, no tax is required to be deducted at source under section 194A on interest on capital of Rs.12,000 paid by the firm to Mr. A, a resident partner.

Section 195, which requires tax deduction at source on payments to non-residents, does not provide for any exclusion in respect of payment of interest by a firm to its non-resident partner. Therefore, tax has to be deducted under section 195 at the rates in force in respect of interest on capital of Rs.24,000 paid to partner Mr. B, a non-resident.

(iii) As per section 10(2A), share of profit received by a partner from the total income of the firm is exempt from tax. Therefore, the share of profit paid to non-resident partner is not liable for

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tax deduction at source.

However, section 195(6) provides that the person responsible for paying any sum, whether or not chargeable to tax, to a non-corporate non-resident or to a foreign company, shall be required to furnish the information relating to payment of such sum in the prescribed form and manner.

Question 6

"Come Air Ltd." has paid a sum of Rs.12 lakhs during the year ended 31-3-2018 to Airports Authority of India towards landing and parking charges. The company has deducted tax at source@2% under section 194C on the said payment and remitted the tax deducted within the prescribed time. The Assessing Officer contended that landing and parking charges were levied for use of the land of the airport and hence, the payment was in the nature of rent attracting TDS@10% under section 194-I. Discuss the correctness or otherwise of the contention of the Assessing Officer.

Answer

The issue as to whether the charges fixed by the Airport Authority of India (AAI) for landing and take-off facilities and parking facility for the aircraft are for the "use of the land" by the airline company came up before the Supreme Court in Japan Airlines Co. Ltd. v. CIT / CIT v. Singapore Airlines Ltd. (2015) 377 ITR 372.

The Supreme Court observed that the charges which are fixed by the AAI for landing and take- off services as well as for parking of aircrafts are not for the "use of the land". These charges are for services and facilities offered in connection with the aircraft operation at the airport which include providing of air traffic services, ground safety services, aeronautical communication facilities, installation and maintenance of navigational aids and meteorological services at the airport.

There are various international protocols which mandate all authorities manning and managing these airports to construct the airport of desired standards which are stipulated in the protocols. The services which are required to be provided by these authorities, like AAI, are aimed at passengers' safety as well as for safe landing and parking of the aircrafts. Therefore, the services are not restricted to merely permitting "use of the land" of airport. On the contrary, it encompasses all the facilities that are to be compulsorily offered by the AAI in tune with the requirements of the protocol.

The Supreme Court observed that the charges levied on air-traffic includes landing charges, lighting charges, approach and aerodrome control charges, aircraft parking charges, aerobridge charges, hangar charges, passenger service charges, cargo charges, etc. Thus, when the airlines pay for these charges, treating such charges as charges for "use of the land" would tantamount to adopting a totally simplistic approach which is far away from reality.

The Supreme Court opined that the substance behind such charges has to be considered and when the issue is viewed from this angle, keeping the larger picture in mind, it becomes very clear that the charges are not for use of the land per se and, therefore, it cannot be treated as "rent" within the meaning of section 194-I. The Supreme Court, thus, concurred with the view taken by the Madras High Court in Singapore Airlines case and overruled the view taken by the Delhi High Court in United Airlines/Japan Airlines case.

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Applying the rationale of the Supreme Court ruling to the facts of this case, the contention of the Assessing Officer that landing and parking charges are levied for use of the land of airport and hence, the charges are in the nature of rent to attract the provisions of tax deduction at source under section 194-I is ***not*** correct.

Question 7

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Mr. Harish, Vice President of ABC Bank, sold his house property in Chennai as well as his rural agricultural land for a consideration of Rs.60 lakh and Rs.15 lakh, respectively, to Mr. Suresh, a retail trader of garments, on 10.10.2017. Mr. Harish had purchased the house property and rural agricultural land in December 2015 for Rs.40 lakh and Rs.10 lakh, respectively. The stamp duty value on the date of transfer, i.e., 10.10.2017, is Rs.85 lakh and Rs.20 lakh for the house property and rural agricultural land, respectively.

(a) Determine the tax implications in the hands of Mr. Harish and Mr. Suresh, if the date of agreement for sale of house property and rural agricultural land is 1.7.2017 and the stamp duty value on the said date was Rs.75 lakh and Rs.15 lakh, respectively. On the said date, Mr. Suresh made payment of Rs.5 lakh by way of account payee cheque to Mr. Harish for purchase of house property. Also, discuss the TDS implications, if any, in the hands of Mr. Suresh, assuming that both Mr. Harish and Mr. Suresh are resident Indians.

(b) Would your answer be different if Mr. Harish is a property dealer and sold the house property in the course of his business?

Answer

(a) Tax implications on sale of rural agricultural land and house property representing a capital asset in the hands of Mr. Harish, a salaried employee

(i)	**Tax implications in the hands of Mr.Harish, a salaried employee**
	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. Harish. However, capital gains would arise on sale of house property, being a capital asset. As per section 50C(1), the stamp duty value of house property on the date of agreement (i.e., Rs.75 lakh) would be deemed to be the full value of consideration arising on transfer of property. Therefore, Rs.35 lakh (i.e., Rs.75 lakh – Rs.40 lakh, being the purchase price) would be taxable as short-term capital gains in the A.Y.2018-19. It may be noted that under first and second proviso to section 50C(1), the stamp duty value on the date of agreement can be adopted as the advance was received on the date of agreement through account payee cheque. As the date of agreement is different from the date of registration and part of the consideration was received on or before the date of agreement by way of account payee cheque, the stamp duty value on the date of agreement is to be adopted as the deemed sale consideration.
(ii)	**Tax implications in the hands of the buyer – Mr.Suresh, a retail trader**

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	The house property purchased would be a capital asset in the hands of Mr. Suresh, who is a retail trader of garments. The provisions of section 56(2)(x) is attracted in the hands of Mr. Suresh who has acquired the immovable property, being a capital asset, for inadequate consideration. For the purpose of section 56(2)(x), Mr. Suresh can take the stamp duty value on the date of agreement

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	instead of the date of registration since he has paid a part of the consideration by account payee cheque on the date of agreement. Therefore, Rs.**15 lakh,** being the difference between the stamp duty value of the property **on the date of agreement** (i.e., Rs.75 lakh) and the actual consideration (i.e., Rs.60 lakh) would be taxable as per section 56(2)(x) under the head "**Income from other sources**" in the hands of Mr. Suresh. As rural agricultural land is not a capital asset, the provisions of section 56(2)(x) are not attracted in respect of acquisition of agricultural land for inadequate consideration, since the definition of "property" under section 56(2)(x) includes only **capital assets** specified thereunder.
(iii)	**TDS implications in the hands of the buyer, Mr.Suresh**
	Since the sale consideration of house property exceeded Rs.50 lakh, Mr. Suresh is required to deduct tax at source under section 194-IA. The tax deduction under section 194-IA would be Rs.60,000, being 1% of Rs.60 lakh. TDS provisions under section 194-IA are not attracted in respect of transfer of rural agricultural land.

Tax implications on sale of house property representing stock-in-trade in the hands of Mr. Harish, a property dealer:

(i)	**Tax implications in the hands of Mr. Harish for A.Y.2018-19**
	If Mr. Harish is a property dealer who has sold the house property in the course of his business, the provisions of section 43CA would be attracted, since the house property represents his stock-in-trade and he has transferred the same for a consideration less than the stamp duty value. For the purpose of section 43CA, Mr. Harish can take the stamp duty value on the date of agreement instead of the date of registration, since he has received part of the sale consideration by a mode other than cash on the date of agreement. Therefore, **Rs.35 lakh**, being the difference between the stamp duty value on the date of agreement (i.e., Rs.75 lakh) and the purchase price (i.e., Rs.40 lakh), would be chargeable as **business income** in the hands of Mr. Harish.
(ii)	**TDS implications and taxability in the hands of Mr. Suresh for A.Y.2018-19**
	There would be no difference in the TDS implications or taxability in the hands of Mr. Suresh, whether Mr. Harish is a property dealer or a salaried employee. Therefore, the provisions of section 56(2)(x) would be attracted in the hands of Mr. Suresh who has received house property, being a capital asset, for inadequate consideration. The TDS provisions under section 194-IA would also be attracted since the actual consideration for house property exceeds Rs.50 lakh.

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Question 8

Siddharth Hospitals Pvt. Ltd., has recently been accorded recognition by several insurance companies to admit and treat patients on cashless hospitalization basis. Payment to the assessee hospital will be made by Third Party Administrators (TPA) who will process the claims of the patients admitted and make payments to the various hospitals including the assessee. All TPAs are corporate entities. The assessee wants to know whether the TPAs are bound to deduct tax at source under section 194J or under section 194C?

Answer

This issue has been clarified by the CBDT Circular No.8/2009 dated 24.11.2009. As per provisions of section 194J(1), any person, who is responsible for paying to a resident any sum by way of fees for professional services, shall, 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, deduct an amount equal to 10% of such sum as TDS.

Further, as per clause (a) of Explanation to section 194J "professional services" includes services rendered by a person in the course of carrying on medical profession.

The services rendered by hospitals to various patients are primarily medical services and, therefore, **the provisions of section 194J are applicable on payments made by TPAs to hospitals** etc. Further, for invoking provisions of section 194J, there is no stipulation that the professional services have to be necessarily rendered to the person who makes payment to hospital. Therefore, TPAs 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.

In view of the above, all such transactions between TPAs and hospitals would fall within the ambit of provisions of section 194J.

Question 9

Examine in the context of provisions contained in Chapter XVII of the Act and also work out the amount of tax to be deducted by the payer of income in the following cases:

(i) Payment of Rs.5 lacs made by JCP & Co. to Pingu Events Co. Ltd. for organizing a debate competition on the subject "Preservation of Rural Heritage of Rajasthan".

(ii) "Profit Commission" of Rs.1 lac paid on 10.6.2017 by a re-insurance company to the insurer company after the expiry of the term of insurance and where there was no claim during the treaty.

(iii) KD, a part time director of DAF Pvt. Ltd. was paid an amount of Rs.2,25,000 as fees which was actually in the nature of commission on sales for the period 1.4.2017 to 30.6.2017.

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Answer

(i) The services of Event Managers in relation to sports activities alone have been notified by the CBDT as "professional services" for the purpose of section 194J. In this case, payment of Rs.5 lacs was made to an event management company for organization of a debate competition. Hence, the provisions of section 194J are not attracted.

However, TDS provisions under section 194C relating to contract payments would be attracted and consequently, tax has to be deducted @ 2% under section 194C. The tax deductible under section 194C would be Rs.10,000, being 2% of Rs.5 lacs.

(ii) Section 194D requires deduction of tax at source@5% from insurance commission, where the commission exceeds Rs.15,000.

Reinsurance is different from insurance since there is no direct contractual relationship between the person insured and the re-insurer.

In order to attract section 194D, the commission or any other payment covered under the section should be a remuneration or reward for soliciting or procuring the insurance business. The insurance companies do not procure business for the reinsurance company nor does the reinsurer pay commission or other payment for soliciting the business from the insurance companies. Therefore, section 194D has no application.

Hence, when profit commission is paid by a reinsurance company to an insurance company, after the expiry of the term of insurance, in respect of cases where there is no claim during the operation of the reinsurance treaty, tax deduction under section 194D is not attracted.

(iii) Section 194J provides for deduction of tax at source @10% on any remuneration or fees or commission, by whatever name called, paid to a director, which is not in the nature of salary in respect of which tax is deductible at source under section 192.

Hence, tax is to be deducted at source under section 194J @10% by DAF Pvt. Ltd. on the commission of Rs.2,25,000 paid to KD, a part-time director. The tax deductible under section 194J would be Rs.22,500, being 10% of Rs.2,25,000.

Question 10

Examine the applicability of the provisions relating to deduction of tax at source in the following transactions:

(i) Max Limited pays Rs.1,02,000 to Mini Limited, a resident contractor who, under the contract dated 15th October, 2017, manufactures a product according to specification of Max Limited by using materials purchased from Max Limited.

(ii) A company operating a television channel makes payment of Rs.5 lacs to a former cricketer for making running commentary of a one-day cricket match.

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(iii) EL Ltd., a foreign company, pays outside India, salary to its employee, Mr. Raghavan, a foreign national and a non-resident, for services rendered in India.

Answer

(i) The definition of "work" under section 194C includes manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer. In the instant case, Mini Limited manufactures the product as per the specification given by Max Limited **by using the raw materials purchased from Max Limited**. **Therefore, it falls within the definition of "work"** under section 194C. Consequently, tax is to be deducted on the invoice value excluding the value of material purchased from such customer if such value is mentioned separately in the invoice. If the material component is not mentioned separately in the invoice, tax is to be deducted on the whole of the invoice value.

(ii) Provisions for deduction of tax at source under section 194J are attracted in respect of payment of fees for professional services, if the amount of such fees exceeds Rs.30,000 in the relevant financial year. The service rendered by a commentator in relation to sports activities has been notified by the CBDT as a professional service for the purposes of section 194J vide its Notification No. 88 dated 21st August, 2008. Therefore, tax is required to be deducted@10% from the fee of Rs.5 lacs payable to the former cricketer.

(iii) Section 195 requires deduction of tax at source by any person responsible for making payment to a non-resident, any interest or any other sum chargeable under the provisions of the Income-tax Act, 1961 (other than income chargeable under the head "Salaries").

Section 192(1) requires "any person" responsible for paying income under the head "Salaries" to deduct tax at source. Therefore, even if the payer is a foreign company, section 192 would be applicable.

TDS provisions under section 192 are attracted, if the salary payable to a non-resident is chargeable to tax in India. Under section 9(1)(ii), income which falls under the head "Salaries" shall be deemed to accrue or arise in India, if it is earned in India. Salary payable for service rendered in India shall be regarded as income earned in India. Therefore, salary paid to Mr. Raghavan, a non-resident, attracts tax liability in India, as he has rendered services in India and the salary is attributable to such services.

Therefore, the foreign company, EL Limited, is liable to deduct tax at source under section 192 from the salary of Mr. Raghavan.

Question 11

Examine in the following cases the obligation of the person paying the income in respect of tax deduction at source and indicate the due date for payment of such tax, wherever applicable:

(i) MNO Ltd., the employer, credited salary due for the financial year 2017-18 amounting to Rs.3,40,000 to the account of Q, an employee, in its books of account on 31.3.2018. Q has not

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furnished any information about his income/loss from any other head or proof of investments/payments qualifying for deduction under section 80C.

(ii) T, an individual whose total sales in business during the year ended 31.3.2017 was Rs.2.20 crores, paid Rs.9 lacs by cheque on 1.1.2018 to a contractor (an individual), for construction of his factory building. No amount was credited earlier to the account of the contractor in the books of T.

(iii) BCD Ltd. credited Rs.28,000 towards fees for professional services and Rs.27,000 towards fees for technical services to the account of HG in its books of account on 6.10.2017. The total sum of Rs.55,000 was paid by cheque to HG on 18.12.2017.

Answer

(i) Section 192 requires deduction of tax from salary at the time of payment. Thus, the employer is not required to deduct tax at source when salary has not been paid but is merely credited to the account of the employee in its books of account. MNO Ltd. therefore, is not required to deduct tax at source in respect of the salary merely credited to the account of employee Q which is not paid.

If salary has been paid during the year to Q, then, MNO Ltd has to obtain from Q, the evidence/proof/particulars of prescribed claims (including claim for set-off of loss) under the provisions of the Act in such form and manner as may be prescribed.

If Q has not furnished any information about his income/loss under any other head or proof of investments/expenditure qualifying for deduction under section 80C, then, the employer has to deduct tax without considering any claim for any expenditure or set-off of losses or deduction under section 80C.

(ii) An individual who is liable for tax audit under section 44AB in the immediately preceding financial year is liable to deduct tax at source under section 194C for the financial year 2017-18 in respect of the payment made to contractor exceeding Rs.30,000 in a single contract and Rs.1,00,000 in aggregate of contracts during the financial year. Turnover of the individual T is Rs.2.20 crores in the financial year 2016-17. Therefore, T is liable to get his accounts for that year audited under section 44AB. As the payment during financial year 2017-18 to the contractor has exceeded the limits prescribed in section 194C, tax has to be deducted under section 194C.

The rate of tax deduction is 1% as the contractor is an individual.

(iii) The limit of Rs.30,000 for non-deduction of tax under section 194J would apply separately for fees for professional services and fees for technical services. This means that if a person has rendered services falling under both the categories, tax need not be deducted if the fee for each category does not exceed Rs.30,000 even though the aggregate of the amounts credited to the account of such person or paid to him for both the categories of services exceed

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Rs.30,000. Therefore, BCD Ltd. is not required to deduct tax at source in respect of the fees either at the time of credit or at the time of payment.

Question 12

Examine the liability for tax deduction at source in the following cases for the assessment year 2018-19:

(i) Mr. Anand has been running a sole proprietary business whose accounts are audited under section 44AB with turnover of Rs.202 lakhs for the A.Y. 2017-18. He pays a monthly rent of Rs.10,000 for the office premises to Mr. R, the owner of building and an individual. Besides, he also pays service charges of Rs.6,000 per month to Mr. R towards the use of furniture, fixtures and vacant land appurtenant thereto.

(ii) By virtue of an agreement with a nationalised bank, a catering organisation receives a sum of Rs.50,000 per month towards supply of food, water, snacks etc. during office hours to the employees of the bank.

(iii) An Indian company pays gross salary including allowances and monetary perquisites amounting to Rs.6,80,000 to its General Manager. Besides, the company provides non- monetary perquisites to him whose value is estimated at Rs.1,20,000.

(iv) A notified infrastructure debt fund eligible for exemption under section 10(47) of the Income- tax Act, 1961 pays interest of Rs.5 lakhs to a company incorporated in USA. The US Company incurred expenditure of Rs.12,000 for earning such interest. The fund also pays interest of Rs.3 lakhs to Mr.X, who is a resident of a notified jurisdictional area.

Answer

(i) Where the payer is an individual or HUF whose turnover exceeds the monetary limits specified in clause (a) of section 44AB, he has to deduct tax at source. Since the turnover of Mr. Anand was Rs.202 lakhs for the A.Y.2017-18, he is liable to deduct tax at source under section 194-I in respect of rental payments during the financial year 2017-18.

Accordingly, Mr. Anand is liable to deduct tax at source under section 194-I on the rental payments made. Section 194-I provides that rent includes any payment, by whatever name called, for the use of land or building together with furniture, fittings etc. Therefore, in the given case, apart from monthly rent of Rs.10,000 p.m., service charge of Rs.6,000 p.m. for use of furniture and fixtures would also attract TDS under section 194-I. Since the aggregate rental payments to Mr. R during the financial year 2016-17 exceeds Rs.1,80,000, Mr. Anand is liable to deduct tax at source @10% under section 194-I from rent paid to Mr. R.

(ii) The definition of "work" under Explanation to section 194-C includes catering services and therefore, TDS provisions under section 194C are attracted in respect of payments to a caterer. As the payment exceeds Rs.30,000, the nationalised bank is required to deduct tax at source at 2% on the payments made to catering organisation under 194-C. If the catering organization is an individual or HUF, then the tax deduction shall be @1%.

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(iii)

	Rs.
Gross salary, allowances and monetary perquisites	6,80,000
Non-Monetary perquisites	1,20,000
	8,00,000
Tax Liability	74,675
Average rate of tax (Rs.74,675 / Rs.8,00,000 × 100)	9.33%

The company can deduct Rs.74,675 at source from the salary of the General Manager. Alternatively, the company can pay tax on non-monetary perquisites as under –

Tax on non-monetary perquisites = 9.33% of Rs.1,20,000 = Rs.11,196
Balance to be deducted from salary = Rs.63,479

If the company pays tax of Rs.11,196 on non-monetary perquisites, the same is not a deductible expenditure as per section 40(a). The amount of tax paid towards non-monetary perquisite by the employer, however, is not chargeable to tax in the hands of the employee as per section 10(10CC).

(iv) As per section 194LB, tax would be deductible @ 5% on gross interest paid/credited by a notified infrastructure debt fund, eligible for exemption under section 10(47), to a foreign company.

In the first case, since the payment is to a foreign company, education cess @ 2% and secondary higher education cess @1% have to be added to the applicable rate of TDS. Therefore, the tax deductible under section 194LB would be Rs.25,750 (i.e., 5.15% of Rs.5 lakhs).

However, in case the notified infrastructure debt fund pays interest to a person who is a resident of a notified jurisdictional area, section 94A will apply. Accordingly, tax would be deductible @30% (plus education cess@2% and secondary and higher education cess@1%) under section 94A, even though section 194LB provides for deduction of tax at a concessional rate of 5%. Therefore, the tax deductible in respect of payment of Rs. 3 lakh to Mr. X, who is a resident of a notified jurisdictional area, would be Rs. 92,700, being 30.9% of Rs.3,00,000.

Question 13

The following issues arise in connection with the deduction of tax at source under Chapter XVII-B. Examine the liability for tax deduction in these cases:

(a) An employee of the Central Government receives arrears of salary for the earlier 3 years. He enquires whether he is liable for deduction of tax on the entire amount during the current year.

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(b) A T.V. channel pays Rs.10 lakh on 1.9.2017 as prize money to the winner of a quiz programme, "Who will be a Millionaire"?

(c) State Bank of India pays Rs.50,000 per month as rent to the Central Government for a building in which one of its branches is situated.

(d) A television company pays Rs.80,000 to a cameraman for shooting of a documentary film.

(e) A State Government pays Rs.22,000 on 2.7.2017 as commission to one of its agents on sale of lottery tickets.

(f) A Turf Club awards a jack-pot of Rs.5 lakh to the winner of one of its races on 1.2.2018.

Answer

(a) As per section 192, tax is deductible at source by any person who is responsible for paying any income chargeable under the head 'Salaries'. However, as per sub-section (2A) of that section, the employee will be entitled to relief under section 89 and consequently he will be required to furnish to the person responsible for making the payment, such particulars in the prescribed form (i.e., Form No.10E). The person responsible for making the payment shall compute the relief and take into account the same while deducting tax at source from salary.

(b) Under section 194B, the person responsible for paying by way of winnings from any card game and other game in an amount exceeding Rs.10,000 shall at the time of payment deduct income-tax at 30%. Therefore, tax of Rs.3 lakh has to be deducted at source from the prize money of Rs.10 lakh payable to the winner.

(c) Section 194-I, which governs the deduction of tax at source on payment of rent, exceeding Rs.1,80,000 p.a., is applicable to all taxable entities except individuals and HUFs, whose turnover/gross receipts do not exceed the monetary limits specified under clause (a) of section 44AB. Section 196, however, provides exemption in respect of payments made to Government from application of the provisions of tax deduction at source.

Therefore, no tax is required to be deducted at source by State Bank of India from rental payments to the Government.

(d) If the cameraman is an employee of the T.V. Company, the provisions of section 192 will apply. However, if he is a professional, TDS provisions under section 194-J will apply. Tax at 10% will have to be deducted at the time of credit of Rs.80,000 or on its payment, whichever is earlier.

(e) Under section 194G, the person responsible for paying to any person stocking, distributing, purchasing or selling lottery tickets shall at the time of credit of the commission or payment thereof, whichever is earlier, amounting to more than Rs.15,000, deduct income-tax at source @5%.

Accordingly, tax@5% under section 194G amounting to Rs.1,100 has to be deducted from commission payment of Rs.22,000 to the agent of the State Government.

(f) The payment by way of winnings from horse race is governed by section 194BB. Under this

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section, the person responsible for payment shall, at the time of payment, deduct tax at source @ 30%, if the payment exceeds Rs.10,000.

Accordingly, tax@30% amounting to Rs.1,50,000 has to be deducted from the winnings of Rs.5 lakh payable to the winner of the race.

Question 14

Examine and compute the liability for deduction of tax at source, if any, in the cases stated hereunder, for the financial year ended 31st March, 2018

(i) Mr. X, a resident, acquired a house property at Mumbai from Mr. Y for a consideration of Rs.90 lakhs, on 20.6.2017. On the same day, Mr. X made two separate transactions, thereby acquiring an urban plot in Kolkata from Mr. C for a sum of Rs.49,50,000 and rural agricultural land from Mr. D for a consideration of Rs.60 lakhs.

(ii) On 17.6.2017, a commission of Rs.50,000 was retained by the consignee 'ABC Packaging Ltd.' and not remitted to the consignor 'XYZ Developers', while remitting the sale consideration. Examine the obligation of the consignor to deduct tax at source.

(iii) Mr. S won a motor car in a lucky draw held by 'P' marketing. The market price of car was Rs.4,00,000. P marketing erroneously gave the car to Mr. S without deducting tax at source. Examine the liability of P marketing to make such payment, if any.

(iv) Raj is working with AB Ltd. He is entitled to a salary of Rs.45,000 per month w.e.f. 1.4.2017. He has a house property which is self-occupied. He paid an interest of Rs.80,000 on loan, during the previous year 2017-18. The loan was taken for construction of house. He has notified his employer AB Ltd. that there will be a loss of Rs.80,000 in respect of this house property for financial year ended 31.3.2018.

Answer

		Amount of TDS (Rs.)
(i)	Since the consideration for transfer of house property at Mumbai exceeds Rs.50 lakhs, Mr. X, being the transferee, is required to deduct tax @1% under section 194-IA on Rs.90 lakhs, being the amount of consideration for transfer of property.	90,000
	Mr. X is not required to deduct tax as source under section 194-IA from the consideration of Rs.49,50,000 paid to Mr. C for transfer of urban plot, since the consideration is less than Rs.50 lakhs.	Nil
	Mr. X is also not required to deduct tax at source under section 194-IA from the consideration of Rs.60 lakhs paid to Mr. D for transfer of rural agricultural land, since the same is specifically excluded from the scope of immovable property for the purpose of tax deduction under section 194-IA.	Nil

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	Note - Section 194-IA requires 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 the resident transferor, whichever is earlier. However, no tax is required to be deducted where the consideration for transfer of an immovable property is less than Rs.50 lakhs.	
(ii)	Section 194H requires deduction of tax at source@5% from commission and brokerage payments to a resident. However, no tax is to be deducted at source where the amount of such payment does not exceed Rs.15,000. In the given case, 'ABC Packaging Ltd.', the consignee, has not remitted the commission of Rs.50,000 to the consignor 'XYZ Developers' while remitting the sales consideration. Since the retention of commission by the consignee/agent amounts to constructive payment of the same to him by the consignor/principal, deduction of tax at source is required to be made from the amount of commission [CBDT Circular No.619 dated 4/12/1991]. Therefore, XYZ Developers has to deduct tax at source on Rs.50,000 at the rate of 5%.	2,500
(iii)	Section 194B provides that the person responsible for paying to any person any income by way of winnings from any lottery or crossword puzzle, card game and any other game of any sort in an amount exceeding Rs.10,000 shall deduct tax at source @ 30%. However, in case where winnings are wholly in kind, the person responsible for paying shall, before releasing the winnings, ensure that tax has been paid in respect of the winnings. Where the winnings are wholly in kind, the responsibility cast under section 194B is to ensure that tax is paid by the winner of the prize before the prize is released in his favour.	

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	This can be done, by collecting from the winner, a sum equal to the tax deductible at source on the winnings in kind and, thus, meeting the liability for TDS, before releasing the winnings. For this purpose, the value of the winnings in kind shall be taken as the cost incurred by the payer in acquiring the said winnings in kind [Circular No.763 dated 7/2/1998] In the given case, P marketing has released the car without ensuring tax payment of Rs.1,20,000, being 30% of Rs.4,00,000 (being the value of car) by Mr. S. P Marketing is therefore liable for penalty under section 271C and prosecution under section 276B [CIT v. Hindustan Lever Ltd. (2014) 361 ITR 1 (Kar.)]	

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(iv)	Section 192 provides that tax is required to be deducted on the payment made as salaries. Tax is to be deducted on the estimated income at the average of income tax computed on the basis of the rates in force for the financial year in which payment is made. The employee may declare details of his other incomes (including loss under the head "Income from house property" but not any other loss) to his employer. In this case, since Mr. Raj has notified his employer AB Ltd. of loss from self-occupied house property, the employer has to take the same into consideration for deduction of tax at source. Therefore, AB Ltd. is required to deduct tax at source on the salary of Rs.45,000 per month paid to Mr. Raj, in the following manner:		
	Income under the head salaries (45,000 x 12)	5,40,000	
	Income under the head "house property"	(80,000)	
	Gross total income	4,60,000	
	Less: Deduction under Chapter VI-A	Nil	
	Total Income	4,60,000	
	Tax@10% on Rs.2,10,000, being the amount arrived at after reducing the basic exemption limit of Rs.2,50,000 from Rs.4,60,000	10,500	
	Add: Education cess@2% and secondary and higher education cess@1%	315	10,815
	Tax to be deducted at source	10,815	

Question 15

A foreign company seconded some employees to the assessee, an Indian collaborator. These employees worked with the Indian collaborator throughout the P.Y.2017-18. The employees were in receipt of salary from the Indian collaborator. They were also in receipt of special allowance directly from the foreign company in foreign currency outside India. The Indian collaborator deducted tax under section 192, on the component of salary paid by it, without taking into account the special allowance paid abroad by the foreign company in foreign currency to these employees. For this reason, the Revenue authorities treated the Indian collaborator as an 'assessee-in-default' under section 201 for non-deduction of tax at source on the "special allowance" component of salary paid by the foreign company.

Is such treatment by the Revenue Authorities and the consequent levy of interest and penalty justified?

Answer

Section 9(1)(ii) provides that any income which falls under the head "salaries" is deemed to

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accrue or arise in India, if it is earned in India. The Explanation thereto further clarifies that income payable for services rendered in India shall be regarded as income earned in India.

Section 192(1) requires the person responsible for paying any income chargeable under the head "Salaries" to deduct income-tax, at the time of payment, at the average rate of income-tax computed on the basis of the rates in force for the financial year on the amount payable.

Since the TDS provisions relating to payment of income chargeable under the head "Salaries" form an integrated code along with the charging and computation provisions under the Act, section 192(1) has to be read with section 9(1)(ii) and the Explanation thereto. Therefore, if any payment under the head "Salaries" falls within section 9(1)(ii), then TDS provisions under section 192 gets attracted. Consequently, the Indian tax deductor assessee is duty bound to deduct, from the portion of salary paid by it, tax at source under section 192(1) on the entire salary paid to the employee, including special allowance paid abroad to the employee by the foreign company.

It was so held by the Apex Court in CIT, New Delhi v. Eli Lilly & Co. (India) P. Ltd. (2009) 312 ITR 225.

In this case, all the employees are resident in India, since they have worked with the Indian collaborator throughout the previous year 2017-18. If the tax due on special allowance received from the foreign company is paid by the recipient-employees, then, the Indian collaborator would not be treated as an assessee-in-default under section 201(1), if these resident-employees have furnished a return of income under section 139 on or before the due date of filing return of income, disclosing such income, and have also furnished a certificate to this effect from an accountant in the prescribed form. However, interest under section 201(1A)@1% per month or part of month shall be payable by the Indian collaborator from the date on which such tax was deductible to the date of furnishing of return by such resident employee.

In cases where the tax has not been paid by the recipient employee, the Assessing Officer can proceed under section 201(1) to recover the shortfall in payment of tax and interest thereon under section 201(1A).

However, no penalty under section 271C would be attracted, if the Indian collaborator was under the genuine and bona fide belief that it was not under any obligation to deduct tax at source from the special allowance paid by the foreign company. This is provided for under section 273B.

SIGNIFICANT SELECT CASES

1. **Whether "tips" received by the hotel-company from its customers (who made payment through credit card) and distributed to the employees would fall within the meaning of "Salaries" to attract tax deduction at source under section 192?**

   ITC Ltd v. CIT (2016) 384 ITR 14 (SC)

   Facts of the case: The assessee company, engaged in the business of owning, operating and managing hotels, allowed its employees to receive tips from customers. In case of credit

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card payments by the customers, the employer company collected the tips which were later on disbursed to its employees. The Assessing Officer treated the receipt of tips as income under the head "Salaries" in the hands of the employees and contended that the assessee was liable to deduct tax at source from such payments under section 192. As the assessee company had not deducted tax at source on the tips disbursed to the employees, the Assessing Officer treated the assessee as assessee in default under section 201(1).

However, the Commissioner (Appeals) held that the assessee could not be treated as assessee in default under section 201(1) for non-deduction of tax on tips collected by them and disbursed to their employees. Thereafter, the Tribunal also dismissed the appeal of the revenue.

High Court's Decision: The High Court held that the tips would amount to "profit in addition to salary or wages" and hence would fall under section 15 read with section 17(1) and section 17(3). It also held that the while the tips received by the employees directly from customers would be outside the purview of section 192 but the moment a tip is paid by the customer by way of credit card along with the bill amount to the employer, it would assume the character of salary since it goes into the account of the employer after which it is distributed to the employees.

Supreme Court's Observations: The Apex Court analysed the provisions of section 192 and noted that "any person responsible" for paying any income chargeable under the head "salaries" is alone brought into the dragnet of deduction of tax at source. The person responsible for paying an employee an amount which is to be regarded as the employee's income is only the employer. However, in the present case, the person who is responsible for paying the employee is not the employer at all, but a third party, namely, the customer. Thus, income from tips would be chargeable in the hands of employees as "Income from Other Sources". Since such tips are being received from customers and not from the employer, section 192 would not get attracted.

The Supreme Court observed that section 15 applies when an employee has a vested right to claim any salary from an employer or former employer. However, in the case on hand, there

is no vested right on the part of the employee to claim any amount of tips from the employer, since tips are purely voluntary amounts that may or may not be paid by customers for services rendered.

The Supreme Court observed that the amount of tips paid by the employer to the employees had no reference to the contract of employment at all. Tips were received by the employer in a fiduciary capacity as trustee for payments that were received from customers which they disbursed to their employees for service rendered to the customer. There was, therefore, no reference to the contract of employment when these amounts were paid by the employer to the employee.

Therefore, the tips received by the employees could not be regarded as "profits in lieu of salary" in terms of section 17(3). The payment by the employer of tips collected from the customers to the employees would not be a payment made "by or on behalf of" an employer. Such payments would be outside the purview of section 15(b) of the Act.

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The Apex Court observed that the person who paid the tip was the customer and not the employer. Even though the amounts were with the employer he had no title to the money and it was held in a fiduciary capacity as trustee for and on behalf of the employees.

Supreme Court's Decision: The Supreme Court observed that contract of employment is not the proximate cause for the receipt of tips by the employee from a customer hence, it would be outside the dragnet of sections 15 and 17 of the Act. Therefore, it held that, in such a case, no liability to deduct tax at source under section 192 arises, and hence, the assessee company cannot be treated as an assessee in default for non-deduction of tax at source from the amount of tips collected and distributed to its employees.

2. Is section 194A applicable in respect of interest on fixed deposits in the name of Registrar General of High Court?

UCO Bank v. Dy. CIT (2014) 369 ITR 335 (Del)

Facts of the case: The assessee-bank accepted Rs.707.46 lakhs as fixed deposit in the name of Registrar General of the High Court and issued a fixed deposit receipt in compliance with a direction passed by the court in relation to certain proceedings. Subsequently, the Assistant Commissioner of Income-tax issued a show cause notice to the bank for not deducting tax at source on the interest accrued and to show cause as to why it should not be treated as an assessee-in-default under section 201(1)/201(1A). The bank replied that the FDRs in the name of Registrar General of the Court was as a custodian because the actual beneficiary was unknown as the matter was sub judice and tax at source would be deducted when the payment is made to beneficiary as and when it is decided by the court. The Assistant Commissioner, however, passed an order treating the bank as assessee-in-default and raised a demand of Rs.40.33 lakhs and
Rs.14.20 lakhs under sections 201(1) and 201(1A), respectively. Further, he initiated penalty proceedings under section 271C. The assessee preferred a writ challenging the order passed imposing penal interest and initiation of penalty proceedings.

High Court's Opinion and Decision: The High Court opined that in the normal course, the bank is obliged to deduct tax at source in respect of any credit or payment of interest on deposits made with it. However, in this case, the actual payee is not ascertainable and the person in whose name the interest is credited is not a person liable to pay tax under the Act. The deposits kept with the bank under the orders of the court were, essentially, funds which were in custodia legis, that is, funds in the custody of the court. The interest on that account
– although credited in the name of the Registrar General – was also part of funds under the custody of the Court. The Registrar General is not the recipient of the income represented by interest that accrues on the deposits made in his name. The credit of interest is not a credit to the

The High Court observed that in the absence of a payee, the machinery provisions for deduction of tax to his credit are ineffective. The expression "payee" under section 194A would mean the recipient of income whose account is maintained by the person paying interest. The Registrar General is neither recipient of the amount credited to his account nor to interest accruing thereon. Therefore, he cannot be considered as a 'payee' for the purposes of section 194A. The credit by the bank in the name of the Registrar General would, thus, not attract the provisions of section 194A.

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account of a person who is liable to be assessed to tax.

The High Court was of the view that Circular No.8/2011 dated 14.10.2011 makes an assumption that the litigant depositing the money is the account holder with the bank or is the recipient of the income represented by the interest accruing thereon. This assumption is basically erroneous as the litigant who is asked to deposit the money in Court ceases to have any control or proprietary right over these funds. The person to whom the funds would be paid ultimately is determined by the court order and at that stage, tax would be required to be deducted at source to the credit of the recipient. However, the litigant who deposits the funds cannot be stated to be the recipient of income.

The High Court allowed the writ and set aside the orders passed by the tax authorities.

Note *- The CBDT has accepted the aforesaid judgment and accordingly, vide Circular No.23/2015 dated 28.12.2015, clarified that interest on FDRs made in the name of Registrar General of the Court or the depositor of the fund on the directions of the Court, will not be subject to TDS till the matter is decided by the Court. However, once the Court decides the ownership of the money lying in the fixed deposit, the provisions of section 194A will apply to the recipient of the income.*

3. Where the assessee fails to deduct tax at source under section 194B in respect of the winnings, which are wholly in kind, can he be deemed as an assessee-in-default under section 201?

CIT v. Hindustan Lever Ltd. (2014) 361 ITR 0001 (Kar.)

Facts of the case: In the present case, the assessee is a company engaged in the business of manufacture and sale of various consumer goods/products. During the previous years relevant to A.Y.2001-02 and A.Y.2002-03, it had conducted certain sales promotion schemes. The assessee advertised the schemes wherein coupons were inserted in packs/containers of their products. Some of those coupons indicated that on purchase of the packs/ containers, they would get prizes, as indicated in coupons. The prizes that were offered were Santro car, Maruti car, gold chains, gold coins, gold tablas, silver coins, emblems, etc. The total amount of prizes distributed valued Rs.6,51,238 for the A.Y.2001-02 and Rs.54,73,643 for the A.Y.2002-03.

The Assessing Officer, having received the information about the schemes, sought clarification and also conducted survey of the assessee's business premises under section 133A. The Assessing Officer, thereafter, passed an order dated 3.1.2002, under sections 201(1) and 201(1A) for the A.Y.2001-02 and treated the assessee as an assessee-in-default of its obligation in terms of section 194B. Similar order was passed for the A.Y.2002-03. According to the Assessing Officer, the assessee was obliged to ensure that the tax in respect of the winnings, wholly in kind, was remitted before the winnings were released. Having failed to do so, the proceedings under section 201(1) were initiated. The Assessing Officer held that although the customers did not pay anything extra to receive the prize, nevertheless, they had participated in the scheme by purchasing the products advertised to take a chance at winning the prize. It was further held that what has been paid as prize-in- kind in various schemes conducted by the assessee is a lottery on which the tax was deductible under section 194B. As the assessee

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neither deducted the tax nor ensured payment thereof before the winnings were released, he treated the assessee as an assessee-in-default. He passed similar order dated 28.3.2002 for the A.Y.2002-03.

Appellate Tribunal's view: The Tribunal held that the schemes conducted by the assessee were not a lottery, as the said expression was understood up to the A.Y.2001-02. The Tribunal observed that the customers did not pay any excess amount for getting coupons indicating winnings in the packs/containers of products they purchased, and, therefore, nothing was paid by them for participating in the scheme. Accordingly, the Tribunal concluded that although there was an element of chance but as no consideration or payment was made by the customers for the purpose of participation in the lottery with the object of winning the prizes, the schemes conducted by the assessee would not fall within the ambit of section 194B.

The Tribunal further held that having regard to the insertion of Explanation below section 2(24)(ix), the scheme conducted by the assessee would be a lottery for the A.Y.2002-03 but nevertheless they accepted the alternate contention that having regard to Circular No. 390, dated August 8, 1984 [See (1984) 149 ITR (St.) 5], there was no obligation on the respondent to deduct tax at source in respect of prizes paid in kind and in the absence of any such obligation, no proceedings under section 201 could be taken against the respondent.

High Court's view: From a bare perusal of section 194B, it is clear that the person responsible for paying to any person any income by way of winnings from any lottery in an amount exceeding ten thousand rupees shall, at the time of payment thereof, deduct income- tax thereon at the rates in force. A combined reading of sections 194B and 201 shows that if any such person fails to "deduct" the whole or any part of the tax or after deducting, fails to pay the tax as required by or under the Act, then such person shall, without prejudice to any other consequences which he may incur, be deemed to be an assessee in default in respect of such tax. **The provisions contained in these sections do not cast any duty to deduct tax at source where the winnings are wholly in kind. If the winnings are wholly in kind, as a matter of fact, there cannot be any deduction of tax at source. The word "deduction" employed in this provision postulates a reduction or subtraction of an amount from a gross sum to be paid and payment of the net amount thereafter.** Where the winnings are wholly in kind the question of deduction of any sum therefrom does not arise and in that eventuality, the only responsibility, as cast under section 194B, is to ensure that tax is paid by the winner of the prize before the prize or winnings is or are released in his favour.

High Court's Decision: The High Court observed that if the assessee fails to ensure that tax is paid before the winnings are released in favour of the winner, then, section 271C empowers the Joint Commissioner to levy penalty equivalent to the amount of tax not paid, and under section 276B, such non-payment of tax is an offence attracting rigorous imprisonment for a term which shall not be less than three months but which may extend to seven years and with fine. However, the High Court held that proceedings under section 201 cannot be initiated against the assessee.

4. Can the transmission, wheeling and SLDC charges paid by a company engaged in

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distribution and supply of electricity, under a service contract, to the transmission company be treated as fees for technical services so as to attract TDS provisions under section 194J or in the alternative, under 194C?

Ajmer Vidyut Vitran Nigam Ltd., In re (2013) 353 ITR 640 (AAR)

Facts of the case: In the present case, the applicant is a government company engaged in the business of distribution and supply of electricity to customers in various districts of Rajasthan. The activity of distribution is preceded by the production of electricity and its transmission from the point of production to the point of distribution. The production is by the generating company, which is another entity and transmission to the applicant is through the transmission system network of the transmission company. The transmission company carries the electrical energy to the applicant at the distribution system network of the applicant. The applicant then distributes the energy to the end customers.

The transmission of electricity from the point of generation to the point of distribution of the applicant is termed as "wheeling". The applicant pays transmission and wheeling charges for this wheeling, which it contends are statutory charges. The transmission company also functions as a State Load Dispatch Centre (SLDC), which is responsible for the general co- ordination of production and transmission of electricity to ensure uniform distribution in the State. The applicant pays to the transmission company, SLDC charges, which it claims as statutory in nature, since the levy is in terms of the Electricity Act, 2003.

Applicant's contention: The applicant contended that the above charges were not in the nature of fees for technical services to attract TDS provisions under section 194J, on the following grounds –

(i) The transmission does not involve rendering of any technical services nor were technically qualified staff of the transmission company involved in the transmission of electrical energy;

(ii) The SLDC charges were also mere statutory charges and does not involve rendering of technical services;

(iii) The payment of transmission, wheeling and SLDC charges were in the nature of reimbursement of actual cost and hence, do not generate any income in the hands of the transmission company.

Revenue's contention: The Revenue, on the other hand, was of the view that the transmission of electrical energy from the point of generation to the point of distribution of the applicant involves rendering of technical services and consequently, the applicant was bound to withhold tax. The Revenue supported its view on the basis of the following contentions –

(i) Transmission of electrical energy is a technical service and requires constant involvement of a technical system consisting of sophisticated instruments, constant monitoring and supervision by persons with a technical ability and knowledge to operate and manage the system so as to ensure regular and consistent supply of electricity at the grid voltage at the distribution point of the applicant.

(ii) As regards SLDC charges, the services rendered require the technical support and services

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of technically qualified staff and therefore they were technical services within the meaning of section 194J.

(iii) The fact that the contract between both the parties is backed by a statutory obligation cannot alter the nature of services rendered.

AAR's Observations: The AAR did not agree with the applicant's contention regarding transmission and wheeling charges not constituting fees for technical services on the ground that no rendering of technical services was involved for maintaining proper and regular transmission of electrical energy. It was also not in agreement with the applicant's argument that the services of technical personnel were not needed for ensuring due and proper transmission of electrical energy from the generation point to the distribution point. The AAR concurred with the Revenue's view that the personnel of the transmission company had to ensure regular and consistent transmission of electrical energy at the grid voltage at the

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distribution point of the applicant.

AAR's Decision: The AAR, considering the definition of fees for technical services under section 9(1)(vii) and the process involved in proper transmission of electrical energy, held that transmission and wheeling charges paid by the applicant to the transmission company are in the nature of fees for technical services, in respect of which the applicant has to withhold tax thereon under section 194J.

As regards SLDC charges, the AAR opined that the main duty of the SLDC is to ensure integrated operation of the power system in the State for optimum scheduling and dispatch of electricity within the State. The SLDC charges paid appeared to be more of a supervisory charge with a duty to ensure just and proper generation and distribution in the State as a whole. Therefore, such services were not in the nature of technical service to the applicant; Resultantly, it does not attract TDS provisions under section 194J or under section 194C.

5. Can discount given to stamp vendors on purchase of stamp papers be treated as 'commission or brokerage' to attract the provisions for tax deduction under section 194H?

CIT v. Ahmedabad Stamp Vendors Association (2012) 348 ITR 378 (SC)

Issue: The principal issue in this case is whether stamp vendors are agents of the State Government who are being paid commission or brokerage or whether the sale of stamp papers by the Government to the licensed vendors is on "principal-to-principal" basis involving a "contract of sale".

High Court's Observations: On this issue, the Gujarat High Court had in, Ahmedabad Stamp Vendors Association v. Union of India (2012) 348 ITR 378, observed that the crucial question is whether the ownership in the stamp papers passes to the stamp vendor when the treasury officer delivers stamp papers on payment of price less discount. The Gujarat Stamp Supply and Sales Rules, 1987 contemplates that the licensed vendor, while taking delivery of the stamp papers from the Government offices, is purchasing the stamp papers. The Rules also indicate that the discount which the licensed vendor has obtained from the Government is on purchase of the stamp papers.

If the licensed stamp vendors were mere agents of the State Government, no sales tax would have been leviable when the stamp vendors sell the stamp papers to the customers, because it would have been sale by the Government "**through**" stamp vendors. However, entry 84 in Schedule I to the Gujarat Sales Tax Act, 1969 specifically exempts sale of stamp papers by the licensed vendors from sales-tax. The very basis of the State Legislature enacting such exemption provision in respect of sale of stamp papers by the licensed vendors makes it clear that the sale of stamp papers by the licensed vendors to the customers would have, but for such exemption, been subject to sales tax levy. The question of levy of sales tax arises only because the licensed vendors themselves sell the stamp papers on their own and not as

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agents of the State Government. Had they been treated as agents of the State Government, there would be no question of levy of sales tax on sale of stamp papers by them, and consequently, there would have been no necessity for any exemption provision in this regard.

Therefore, although the Government has imposed a number of restrictions on the licensed stamp vendors regarding the manner of carrying on the business, the stamp vendors are required to purchase the stamp papers on payment of price less discount on "principal to principal" basis and there is no "contract of agency" at any point of time. The definition of "commission or brokerage" under clause (i) of the Explanation to section 194H indicates that the payment should be received, directly or indirectly, by a person acting on behalf of another person, inter alia, for services in the course of buying or selling goods. Therefore, the element of agency is required in case of all services and transactions contemplated by the definition of "commission or brokerage" under Explanation (i) to section 194H. When the licensed stamp vendors take delivery of stamp papers on payment of full price less discount and they sell such stamp papers to the retail customers, neither of the two activities (namely, buying from the Government and selling to the customers) can be termed as service in the course of buying and selling of goods. The High Court, therefore, held that discount on purchase of stamp papers does not fall within the expression "commission or brokerage" to attract the provisions of tax deduction at source under section 194H.

Supreme Court's Decision: The Supreme Court affirmed the above decision of the High Court holding that the given transaction is a sale and the discount given to stamp vendors for purchasing stamps in bulk quantity is in the nature of cash discount and consequently, section 194H has no application in this case.

6. Can incentives given to stockists and distributors by a manufacturing company be treated as "commission" to attract –

(i) the provisions for tax deduction at source under section 194H; and

(ii) consequent disallowance under section 40(a)(ia) for failure to deduct tax at source?

CIT v. Intervet India P Ltd (2014) 364 ITR 238 (Bom)

Facts of the case: The assessee-company engaged in manufacture of biological vaccines and animal health care pharmaceutical products, sold the same either through consignment or commission agents or directly through distributors or stockists. During the relevant financial year, it introduced a sales promotion scheme to boost sales by way of product discounts and product campaign. It passed on the incentives to distributors through consignment agents by way of sales credit notes. The Assessing Officer held that as the assessee was paying the stockists/distributors for the services rendered by them for buying and selling goods, on the basis of quantum of sales effected, such payment has to be considered as commission, on which tax was deductible at source under section 194H. Consequently, disallowance under section 40(a)(ia) was attracted for failure to deduct tax at source.

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High Court's Observations: The High Court observed that the assessee had undertaken sales promotion by way of product discount scheme under which it offered incentive to the stockists / distributors and dealers. **The relationship between the assessee and the distributors / stockists was that of principal to principal.** The products were firstly sold to distributors / stockists who in turn resold the goods in the market. No service was offered by the assessee to them except a discount under the product discount scheme/product campaign scheme to buy the assessee's product.

High Court's Decision: The High Court, accordingly, held that the stockists and distributors were not acting on behalf of the assessee and most of the credit was by way of goods on meeting the sales target which could not be said to be a commission within the meaning of the *Explanation (i)* to section 194H. Accordingly, the High Court affirmed the order of the Tribunal which held that such payment does not attract deduction of tax at source. Consequently, disallowance under section 40(a)(ia) would not be attracted.

7. Can discount given on supply of SIM cards and pre-paid cards by a telecom company to its franchisee be treated as commission to attract the TDS provisions under section 194H?
Bharti Cellular Ltd. v. ACIT (2013) 354 ITR 507 (Cal.)

High Court's Observations: On this issue, the Calcutta High Court observed the Supreme Court ruling in Bhopal Sugar Mills' case (1977) 40 STC 42, wherein it was held that the true relationship between the parties has to be gathered from the nature of the contract, its terms and conditions. The terminology used by the parties is not decisive of the said relationship.

The High Court, on perusal of the agreement between the assessee-telecom company and the franchisees, observed that –

(1) the property in the start-up pack and pre-paid coupons, even after transfer and delivery to the franchisee, remained with the assessee-telecom company;
(2) the franchisee really acted as a facilitator and/or instrument of providing services by the assessee-telecom company to the ultimate subscriber;
(3) the franchisee had no free choice to sell the pre-paid coupons and sim cards and everything including the selling price was regulated by the assessee-telecom company;
(4) the rate at which the franchisee sells to the retailers is also regulated and fixed by the assessee-telecom company.

In the real sense, the franchisee acted on behalf of the assessee-telecom company for selling start-up pack, prepaid recharge coupons to the customer. Therefore, the relationship between the assessee and the franchisee is essentially that of principal and agent, though the nomenclature used is "franchisee". The franchisees were, thus, agents of the assessee, getting a fixed percentage of commission, in the form of discount.

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High Court's Decision: Considering the above, the High Court held that there is an indirect payment of commission, in the form of discount, by the assessee-telecom company to the franchisee. Therefore, the assessee is liable to deduct tax at source on such commission as per the provisions of section 194H.

Note - *Similar ruling was pronounced by the Kerala High Court in Vodafone Essar Cellular Ltd. v. ACIT (TDS) (2011) 332 ITR 255, wherein it was held that there was no sale of goods involved as claimed by the assessee-telecom company and the entire charges collected by the assessee from the distributors at the time of delivery of SIM cards or recharge coupons were only for rendering services to ultimate subscribers. The assessee was accountable to the subscribers for failure to render prompt services pursuant to connections given by the distributor. Therefore, the distributor only acted as a middleman on behalf of the assessee for procuring and retaining customers and consequently, the discount given to him was within the meaning of commission on which tax was deductible under section 194H.*

8. Can the difference between the published price and the minimum fixed commercial price be treated as additional special commission in the hands of the agents of an airline company to attract TDS provisions under section 194H, where the airline company has no information about the exact rate at which tickets are ultimately sold by the agents?

CIT v. Qatar Airways (2011) 332 ITR 253 (Bom.)

Facts of the case: In this case, the airline company sold tickets to the agents at a minimum fixed commercial price. The agents were permitted to sell the tickets at a higher price, however, up to the maximum of published price. Commission at the rate of 9% of published price was payable to the agents of the airline company, on which tax was deducted under section 194H. The issue under consideration is whether the difference between the published price and the minimum fixed commercial price amounts to additional special commission in the hands of the agents to attract the provisions of section 194H.

High Court's Observations: On this issue, the Bombay High Court observed that the difference between the published price and minimum fixed commercial price cannot be taken as additional special commission in the hands of the agents, since the published price was the maximum price and airline company had granted permission to the agents to sell the tickets at a price lower than the published price. In order to deduct tax at source, the exact income in the hands of the agents must necessarily be ascertainable by the airline company. However, the airline company would have no information about the exact rate at which the tickets were ultimately sold by its agents, since the agents had been given discretion to sell the tickets at any rate between the minimum fixed commercial price and the published price. It would be impracticable and unreasonable to expect the airline company to get a feedback from its numerous agents in respect of each ticket sold.

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High Court's Decision: Thus, tax at source was not deductible on the difference between the actual sale price and the minimum fixed commercial price, even though the amount earned by the agent over and above minimum fixed commercial price would be taxable as income in his hands.

Note - *It may be noted that in the case of CIT v. Singapore Airlines Ltd. (2009) 319 ITR 29, the billing analysis statement clearly indicated the extra commission in the form of special or supplementary commission that was paid to the travel agent with reference to the deal code. Therefore, in that case, the Delhi High Court, held that the supplementary commission in the hands of the agent was ascertainable by the airline company and hence the airline company was liable to deduct tax at source on the same under section 194H.*

9. Are landing and parking charges paid by an airline company to Airports Authority of India in the nature of rent to attract tax deduction at source under section 194-I?

Japan Airlines Co. Ltd. v. CIT / CIT v. Singapore Airlines Ltd. (2015) 377 ITR 372 (SC)

Facts of the case: The assessees in both the cases are foreign airlines. Being international airlines, they fly their aircrafts to several destinations across the world, including New Delhi. For landing the aircrafts and parking thereof at the Indira Gandhi International Airport (IGIA), New Delhi, the Airports Authority of India (AAI) levies charges on these airlines. The airlines are deducting tax @2% under section 194C for payment of landing and parking charges in respect of its aircrafts to AAI and remitting the same. However, the income-tax authorities are of the view that tax is to be deducted at the higher rate applicable under section 194-I (currently, 10%).

Issue under consideration: The issue under consideration is whether landing and parking charges paid by the airline companies to AAI is in the nature of rent to attract tax deduction at source under section 194-I.

Delhi High Court's view vis-a-vis Madras High Court's view: On this issue, contrary views were expressed by the Delhi High Court in Japan Airlines Co. Ltd.'s case and the Madras High Court in Singapore Airlines Ltd.'s case.

The Delhi High Court observed that "rent" as defined in section 194-I has a wider meaning than rent in common parlance and includes any agreement or arrangement for use of land. The Delhi High Court further observed that when the wheels of the aircraft coming into an airport touch the surface of the airfield, use of the land of the airport immediately begins. Similarly, for parking the aircraft in that airport, again, there is use of the land. Therefore, the Delhi High Court, following its own judgment in the case of United Airlines v. CIT (2006) 287 ITR 281 held that landing and parking fee were "rent" within the meaning of the provisions of section 194-I, as they were payments for the use of the land of the airport.

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The Madras High Court, however, expressed a contrary view on the above issue in CIT v. Singapore Airlines Ltd. (2012) 209 Taxman 581 (Mad.). The Court has observed that only if the agreement or arrangement has the characteristics of lease or sub-lease or tenancy for systematic use of the land, the charges levied would fall for consideration under the definition of 'rent' for the purpose of section 194-I.

The Madras High Court further observed that the principles guiding the levy of charges on landing and take-off show that the charges are with reference to the number of facilities provided by the Airport Authority of India in compliance with the international protocols and the charges are not made for any specified land usage or area allotted. The charges are for various facilities offered to meet the requirement of passenger safety and for safe landing and parking of the aircraft. Thus, the charges levied are, at the best, in the nature of fee for the services offered rather than in the nature of rent for the use of the land.

Therefore, the levy of charges, which is not only for the use of land, but for maintenance of various services, including technical services involving navigation, would not automatically bring the transaction and the charges within the meaning of either lease or sub-lease or tenancy or any other agreement or arrangement in the nature of lease or tenancy so that the charges would fall within the meaning of 'rent' as appearing in Explanation to section 194-I.

Thus, the Madras High Court held that going by the nature of services offered by the AAI in respect of landing and parking charges, collected from the assessee, there is no ground to accept that the payment would fit in with the definition of "rent" as given under section 194-I.

Supreme Court's Observations: The Apex Court considered the moot question as to whether landing and take-off facilities on the one hand and parking facility on the other hand would tantamount to use of land. After due consideration of the views of the Delhi High Court and the Madras High Court on this issue, the Supreme Court concluded that the Madras High Court's view is justified on the basis of sound rationale and reasoning.

The Supreme Court observed that the charges which are fixed by the AAI for landing and take-off services as well as for parking of aircrafts are not for the "use of the land". These charges are for services and facilities offered in connection with the aircraft operation at the airport which include providing of air traffic services, ground safety services, aeronautical communication facilities, installation and maintenance of navigational aids and meteorological services at the airport.

There are various international protocols which mandate all authorities manning and managing these airports to construct the airport of desired standards which are stipulated in the protocols. The services which are required to be provided by these authorities, like AAI, are aimed at passengers' safety as well as for safe landing and parking of the aircrafts. Therefore, it is not mere "use of the land". On the contrary, it encompasses all the facilities that are to be compulsorily offered by the AAI in tune with the requirements of the protocol.

For example, runways are not constructed like any ordinary roads. Special technology is

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required for the construction of these runways for smooth landing and take-off of the aircrafts. Specialised kind of orientation and dimensions are needed for these runways which are prescribed with precision and those standards are to be adhered to. Further, there has to be proper runway lighting, runway safety area, runway markings, etc. Technical specifications for such lighting, safety area and markings are stipulated which have to be provided. The technical specifications keep in mind the basic fact, namely, on landing, the aircraft is light on fuel and usually less than 5% of the weight of the aircraft touches the runway in one go. On take-off, the aircraft is heavy but as the aircraft accelerates, the weight gradually moves from the wheels to the wings. The technological aspects of these runways have been emphasized in some detail to highlight the precision in designing and engineering which goes into making these runways fool proof for safety purposes. The purpose is to show that the AAI is providing all these facilities for landing and take-off of an aircraft and in this whole process, "use of the land" pales into insignificance.

The Supreme Court observed that the charges levied on air-traffic includes landing charges, lighting charges, approach and aerodrome control charges, aircraft parking charges, aerobridge charges, hangar charges, passenger service charges, cargo charges, etc. Thus, when the airlines pay for these charges, treating such charges as charges for "use of the land" would tantamount to adopting a totally simplistic approach which is far away from the reality.

Supreme Court's Decision: The Supreme Court opined that the substance behind such charges has to be considered and when the issue is viewed from this angle, keeping the full and larger picture in mind, it becomes very clear that the charges are not for use of the land *per se* and, therefore, it cannot be treated as "rent" within the meaning of section 194-I. The Supreme Court, thus, concurred with the view taken by the Madras High Court in *Singapore Airlines* case and overruled the view taken by the Delhi High Court in *United Airlines/Japan Airlines* case.

The Supreme Court was, however, not in agreement with the Madras High Court's view that the words "any other agreement or arrangement for the use of any land or any building" have to be read ejusdem generis and it should take its colour from the earlier portion of the definition, namely, "lease, sub-lease and tenancy", thereby, limiting the ambit of the words "any other agreement or arrangement". The Supreme Court observed that this reasoning was not correct. A bare reading of the definition of "rent" contained in Explanation to section 194-I would make it clear that in the first place, the payment, by whatever name called, under any lease, sub-lease, tenancy is to be treated as "rent". This is rent as understood in the traditional sense. However, the second part is independent of the first part which gives a much wider scope to the term "rent". Accordingly, whenever payment is made for use of any land or any building by any other agreement or arrangement, that is also to be treated as "rent". Once such a payment is made for use of land or building under any other agreement or arrangement, such agreement or arrangement gives the definition of "rent" a very wide

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connotation. The Supreme Court observed that the interpretation of the Delhi High Court appears to be correct to that extent i.e., to the extent that the scope of the definition of rent under section 194-I is very wide and not limited to what is understood as rent in common parlance; though the Delhi High Court did not apply this definition correctly to the present case as it failed to notice that in substance the charges paid by these airlines are not for "use of land" but for other facilities and services wherein the use of the land was only a minor and insignificant aspect. Thus, the Supreme Court was of the considered view that the Delhi High Court did not correctly appreciate the nature of charges that are paid by the airlines as landing and parking charges, in the sense, it did not appreciate that such charges were not, in substance, for use of land but for various other facilities extended by the Airports Authority of India to the airlines.

10. Is payment made for use of passive infrastructure facility such as mobile towers subject to tax deduction under section 194C or section 194-I?

Indus Towers Ltd v. CIT (2014) 364 ITR 114 (Del)

Facts of the case: The assessee owned a network of telecom towers and infrastructure services which were let out to major telecom operators in the country. Under section 197, the assessee sought for lower tax deduction under section 194C for the financial year 2013-14 at 0.5% and whereas the Assessing Officer issued a certificate under section 197 for lower tax deduction at 2.5% under section 194-I. The assessee filed a writ before the Delhi High Court. The Court directed the assessee to prefer a revision petition before the Commissioner of Income-tax.

The Commissioner of Income-tax rejected the contention of the assessee for applying section 194C and upheld the order of the Assessing Officer applying section 194-I, on the ground that the mobile operators had the right to install the equipment on the tower owned by the assessee, which tantamounts to use of the land or telecommunication site and the tower owned by the assessee. The assessee once again preferred a writ before the High Court.

Assessee's Contentions: The assessee explained that its responsibility is to provide the entire passive infrastructure service with the aid of equipment belonging to it which is fully operated, controlled and managed by it. The customers do not have access, control or possession over the towers, sites or designated areas which are limited to rectification or maintenance of any defects in the equipments installed by them. The assessee, further, contended that its customers do not pay for any leasing rights but only for the services. Therefore, the provisions of section 194-I would not be attracted in this case.

High Court's Observations: The High Court observed that it was the intention of the parties to use the technical and specialized equipment maintained by the assessee. The infrastructure was given for the use of mobile operators. The towers were the neutral platform without which the mobile operators could not operate. Each mobile operator has to carry out this activity, by necessarily renting premises and installing the same equipment. The dominant intention was the use of equipment or plant or machinery and the use of

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premises was only incidental.

High Court's Decision: The High Court held that the submission of the assessee that the transaction is not "renting" is incorrect. Also, the Revenue's contention that the transaction is primarily "renting of land" is also incorrect. The underlying object of the arrangement was the use of machinery, plant or equipment i.e., the passive infrastructure and it is incidental that it was necessary to house the equipment in some premises. It directed that tax deduction be made at 2% as per section 194-I(a), the rate applicable for payment made for use of plant and machinery.

11. In respect of a co-owned property, would the threshold limit mentioned in section 194-I for non-deduction of tax at source apply for each co-owner separately or is it to be considered for the complete amount of rent paid to attract liability to deduct tax at source?

CIT v. Senior Manager, SBI (2012) 206 Taxman 607 (All.)

Facts of the case: In the present case, the assessee was paying rent for the leased premises occupied. The said premise was co-owned and the share of each co-owner was definite and ascertainable. Also, the assessee made payment to each co-owner separately by way of cheque. The assessee did not deduct tax at source under section 194-I stipulating that the payment made to each co-owner was less than the minimum threshold mentioned in the said section (now, Rs.1,80,000) and therefore, no liability to deduct tax at source on the rent so paid is attracted, though the whole rent taken together exceeds the said threshold limit.

Revenue's contentions: The Revenue contended that since the premises let out to the assessee had not been divided/partitioned by metes and bounds, it cannot be said that any specified portion let out to the assessee was owned by a particular person. Therefore, the assessee had to deduct tax at source on the rent so paid assessing the co-owners as association of persons and the threshold limit mentioned in section 194-I was to be seen in respect of the entire rent amount. Hence, the Revenue was of the view that assessee was liable to deduct tax on the payment of rent and interest would be leviable on failure to deduct such tax under section 201.

High Court's Decision: Considering the above mentioned facts, the Allahabad High Court held that, since the share of each co-owner is definite and ascertainable, they cannot be assessed as an association of persons as per section 26. The income from such property is to be assessed in the individual hands of the co-owners. Therefore, it is not necessary that there should be a physical division of the property by metes and bounds to attract the provisions of section 26.

Therefore, in the present case, since the payment of rent is made to each co-owner by way of

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separate cheque and their share is definite, the threshold limit mentioned in section 194-I has to be seen separately for each co-owner. Hence, the assessee would not be liable to deduct tax on the same and no interest under section 201 is leviable.

12. Can the payment made by an assessee engaged in transportation of building material and transportation of goods to contractors for hiring dumpers, be treated as rent for machinery or equipment to attract provisions of tax deduction at source under section 194-I?

CIT (TDS) v. Shree Mahalaxmi Transport Co. (2011) 339 ITR 484 (Guj.)

Facts of the case: In this case, the assessee was engaged in the business of transportation of building material, salt, black trap, iron, etc. During the relevant previous year, the assessee made payment for hiring of dumpers and deducted tax at source at the rate under section 194C applicable for sub-contracts which, according to the Assessing Officer, was not correct as the assessee had taken dumpers on hire and such payments were governed under section 194-I. The Assessing Officer, accordingly, held that the assessee had short deducted tax at source and passed an order under section 201(1) holding the assessee to be an assessee-in-default.

High Court's Observations: The High Court observed that the assessee had given contracts to the parties for the transportation of goods and had not taken machinery and equipment on rent. The Court observed that the transactions being in the nature of contracts for shifting of goods from one place to another would be covered as works contracts, thereby attracting the provisions of section 194C.

High Court's Decision: Since the assessee had given sub-contracts for transportation of goods and not for the renting out of machinery or equipment, such payments could not be termed as rent paid for the use of machinery and the provisions of section 194-I would, therefore, not be applicable.

Note - *Similar ruling was pronounced by the Gujarat High Court on an identical issue in CIT (TDS) v. Swayam Shipping Services (P) Ltd. (2011) 339 ITR 647.*

13. Would transaction charges paid by the members of the stock exchange for availing fully automated online trading facility, being a facility provided by the stock exchange to all its members, constitute fees for technical services to attract the provisions of tax deduction at source under section 194J?

CIT v. Kotak Securities Ltd (2016) 383 ITR 1 (SC)

Facts of the case: The assessee company was engaged in the business of share broking, depositories, mobilisation of deposits and marketing public issues. Being a member of the Bombay Stock Exchange (BSE), it made payment to the Stock Exchange by way of transaction charges in respect of fully automated online trading facility and other facilities. These services are available to all the members of the stock exchange in respect of every

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transaction that is entered into. Revenue contended that tax is deductible at source under section 194J considering such transaction charges as "fees for technical services".

High Court's Decision: The Bombay High Court held that the transaction charges paid by a member of the BSE to the stock exchange to transact business of sale and purchase of shares amounts to payment of a "fee for technical services" and hence, tax is deductible at source under section 194J.

Supreme Court's Observations: The Apex Court made the following observations:

- The services provided by the stock exchange are available to all members in respect of every transaction that is entered into. There is nothing special, exclusive or customized in the service that is rendered by the stock exchange.
- A member who wants to conduct his daily business in the stock exchange has no option but to avail such services. Each and every transaction by a member involves the use of such services provided by the stock exchange for which the member is required to pay transaction charge based on the transaction value besides charges for the membership of the stock exchange.
- Technical services like managerial and consultancy service are in the nature of specialised services made available by the service provider to cater to the special needs of the customer-user as may be felt necessary. **It is the above feature that would distinguish or identify a service provider from a facility offered.**
- However, there is no exclusivity in the services rendered by the stock exchange and each and every member has to avail such service in the normal course of trading in securities in the stock exchange.

Supreme Court's Decision: The Apex Court, accordingly, held that the service provided by the BSE for which transaction charges are paid failed to satisfy the test of specialized, exclusive and individual requirement of the user or the consumer who may approach the service provider for such assistance or service.

Therefore, the transaction charges paid to BSE by its members are not for technical services but are in the nature of payments made for facilities provided by the stock exchange. Such payments would, therefore, not attract the provisions of tax deduction at source under section 194J.

14. Is tax is required to be deducted under section 195 on the demurrage charges paid to a foreign shipping company which is governed by section 172 for the purpose of levy and recovery of tax?

CIT v. V.S. Dempo & Co P Ltd (2016) 381 ITR 303 (Bom) (FB)

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Facts of the case: In the present case, the assessee, being a company engaged in the business of mining and export of processed iron ore as also in construction business, claimed demurrage charges paid to a foreign shipping company on which no tax was deducted at source under section 195 as deductible expenditure. Since tax was not deducted at source under section 195, the Assessing Officer, in view of provisions of section 40(a)(i), disallowed the claim of expenditure in respect of such demurrage charges paid.

High Court's Observations: The High Court took note of the Tribunal's observation that section 40(a)(i) would apply only when there is an obligation to deduct tax at source. The Tribunal placed reliance upon the CBDT Circular No. 723 dated September 19, 1995 to support its conclusion that there was no obligation to deduct tax at source in respect of payment made towards demurrage charges to non-resident shipping company falling within the scope of section 172. The Revenue did not dispute that section 172 applied in the present case. Section 172 is a charging as well as machinery provision in respect of non-resident shipping companies. It provides for determination and collection of tax. Thus, no obligation to deduct at source under section 195 would arise in respect of payment of demurrage charges to such companies.

The High Court also noted that section 172 is a complete code that applies to non-resident Indians and section 195 is part of recovery provision under the Income-tax Act, 1961.

The provisions of section 172 would apply notwithstanding anything contained in the other provision of this Act, for the purpose of the levy and recovery of tax in the case of any ship, belonging to or chartered by a non-resident which carries passengers, etc. shipped at a port in India. Since section 172(1) begins with a non-obstante clause, it would prevail over other provisions of the Act including section 195. Thus, the provisions contained thereunder would take care of the manner of determination of income from shipping business of non-residents as well as the levy and recovery of tax thereon.

High Court's Decision: The High Court, accordingly, held that since section 172 dealing with shipping business of non-residents contains a non-obstante clause and applies both for the purpose of the levy and recovery of tax in the case of any ship carrying passengers etc., belonging to or chartered by a non-resident and shipping at a port in India, there would be no obligation on the payer-assessee to deduct the tax at source under section 195 on payment of demurrage charges to the non-resident shipping company.

15. Is payment made to an overseas agent, who did not perform any service in India, liable for tax deduction at source?

DIT (International Taxation) v. Wizcraft International Entertainment (P) Ltd (2014) 364 ITR 227 (Bom)

Facts of the case: The assessee, an event management company, engaged the services of an agent to bring artistes to India. The assessee-company (i) paid commission to overseas

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agent; (ii) reimbursed the expenses in connection with the visit of the artistes in India; and (iii) paid fees to the artistes in India. The assessee-company deducted tax at source on the fees paid to the international artistes in India but did not deduct tax at source on the commission paid to the agent and on the reimbursement of expenses incurred in India by the artistes.

Assessing Officer's view vis-à-vis Commissioner (Appeals) view: The Assessing Officer contended that the payments made by the assessee including the payment made by way of commission to the agent and payment for reimbursement of expenses in connection with the visit of the artistes to India are liable for tax deduction at source. The Commissioner (Appeals) was of the view that expenses incurred and reimbursed do not constitute income derived by the artistes from their personal activities, so as to be taxable under Article 18 of the Double Taxation Avoidance Agreement between India and UK; and hence, the same is not liable for deduction of tax at source.

Issue: The issue under consideration before the High Court was with regard to deduction of tax on commission paid to overseas agent who never took part in the events organized in India and amount paid as reimbursement of expenses incurred on travelling of artistes.

High Court's Observations: The High Court observed that the assessee has deducted tax on the payments made to artistes for the services rendered in India. In so far as reimbursement of expenses is concerned, it has been verified with supporting documents that it was towards their air travel on which no tax was required to be deducted. With regard to the payment of commission, the agent did not act as a performing artist or entertainer. He was concerned only with the services rendered outside India. Thus, the Tribunal had recorded the finding of fact that the income of the agent did not arise from the personal activities in the contracting status of an entertainer or artist. He only contacted the artistes and negotiated with them for performance in India in terms of the authority given by the assessee. Hence, the commission paid to the overseas agent was not liable to tax in India. Consequently, there was no obligation for deducting tax at source at the time of making payment to the overseas agent.

High Court's Decision: The High Court, therefore, affirmed the decision of the Tribunal and Commissioner (Appeals) holding that the service rendered by the agent was outside India and hence, was not chargeable to tax in India. Thus, the requirement for deducting tax at source under section 195 on such payment does not arise.

16. Can items of finished products from ship breaking activity which are usable as such be treated as "Scrap" to attract provisions for tax collection at source under section 206C?

CIT v. Priya Blue Industries (P) Ltd (2016) 381 ITR 210 (Guj)

Facts of the case: The assessee-company, engaged in ship breaking activity, sold old and used plates, wood etc. It did not produce any document or papers to show collection of tax at

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source on sale of such items and payment thereof to the credit of the Central Government nor was certificate in Form No.27C produced. The Assessing Officer observed that such items were in the nature of scrap and therefore, the assessee was under an obligation to collect tax at source from the buyers of scrap. Accordingly, he raised a demand under section 201(1) and interest under section 201(1A). The assessee claimed that such items are usable as such, and are hence not 'scrap' to attract the provisions for collection of tax at source.

Appellate Authorities' views: The Commissioner (Appeals) observed that the assessee was engaged in ship breaking activity and the products obtained from the activity were finished products which constituted sizable chunk of production done by the ship breakers. The Commissioner (Appeals) agreed with the assessee that such products though commercially known as 'scrap' were definitely not "waste and scrap". He further agreed with the contention of the assessee that the items in question were usable as such and, therefore, do not fall within the definition of "scrap" as given in clause (b) of Explanation to section 206C(1).

The Tribunal firstly recorded a list of items sold by the assessee from the ship breaking activity. It found that the assessee collected and paid tax, for seven items, but did not collect tax at source on certain items viz. old and used plates; non-excisable (exempted) goods like wood etc. It observed that the 'waste and scrap' must be from manufacture or mechanical working of material which is definitely not usable as such because of breakage, cutting up, wear and other reasons. Since the assessee is engaged in ship breaking activity, these items/products are finished products obtained from such activity which are usable as such and hence, are not 'waste and scrap' though commercially known as scrap. Accordingly, the Tribunal also decided the issue in favour of the assessee.

High Court's Decision: The High Court concurred with the views of the Tribunal and held that any material which is usable as such would not fall within the ambit of the expression 'scrap' as defined in clause (b) of the *Explanation* to section 206C.

17. Is levy of interest under section 234B attracted in a case where the assessment order does not contain any specific direction for payment of interest, but is accompanied by form ITNS 150 containing a calculation of interest payable on tax assessed?

CIT v. Bhagat Construction Co (P) Ltd (2016) 383 ITR 9 (SC)

Facts of the case: The assessment order passed did not contain any direction for the payment of interest under section 234B. The appellate order also simply stated that interest is payable under section 234B, without any further substantiation. The amount of interest payable under section 234B was contained in the Income-tax Computation Form or 'Form for Assessment of Tax/Refund (I.T.N.S 150)'.

Apex Court's Observations: The Apex Court observed that the facts of the present case are squarely covered by the three judges' bench decision of this court in the case of Kalyankumar Ray v. CIT (1991) 191 ITR 634, wherein it was held that the Form I.T.N.S 150 is also a form

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for determination of tax payable and when it is signed or initialled by the Assessing Officer, it is certainly an order in writing by the Assessing Officer determining the tax payable within the meaning of section 143(3). The said form also contains the calculation of interest payable on the tax assessed. This form must, therefore, be treated as part of the assessment order.

The Supreme Court further observed that the provisions of section 234B are attracted the moment an assessee liable to pay advance tax has failed to pay such tax or the advance tax paid by him is less than 90% of the assessed tax. The assessee, thus, becomes liable to pay simple interest at 1% for every month or part of the month

Supreme Court's Decision: The Apex Court, accordingly, held that the levy of interest under section 234B is automatic when the conditions specified therein are satisfied and the assessment order is accompanied by the prescribed form containing the calculation of interest payable.

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EXERCISE

Question 1

Rajesh regularly files his return of income electronically. While he was trying to upload his return of income for assessment year 2017-18 on 31st July, 2017, last date for filing the same, he found it extremely difficult to do the same due to network problems and ultimately he became successful in making e-filing of his return only at 1 a.m. on 1st August, 2017. The return contained a claim for carry forward of business loss of ` 1 lakh. This circumstance was recorded in a letter delivered to the office of the Deputy Commissioner of Income Tax on 1st August, 2017 during normal office hours. Rajesh made a request to the CBDT for condonation of delay in filing the return of income.

Discuss whether the CBDT has the power to condone the delay in filing the return of income and permit carry forward of loss in the given circumstance.

Answer

Section 119(2)(b) empowers the CBDT to authorise any income tax authority to admit an application or claim for any exemption, deduction, refund or **any other relief under the Act** after the expiry of the period specified under the Act, to avoid genuine hardship in any case or class of cases. The claim for carry forward of loss in case of late filing of a return is relatable to a claim arising under the category of "any other relief available under the Act". Therefore, the CBDT has the power to condone delay in filing of such loss return due to genuine reasons.

The facts of the case are similar to the case of Lodhi Property Company Ltd. v. Under Secretary, (ITA-II), Department of Revenue (2010) 323 ITR 0441, where the Delhi High Court held that the Board has the power to condone the delay in case of a return which was filed late and where a claim for carry forward of losses was made. The delay was only one day and the assessee had shown justifiable reason for the delay of one day in filing the return of income. If the delay is not condoned, it would cause genuine hardship to the assessee. Therefore, the Court held that the delay of one day in filing of the return had to be condoned.

Applying the rationale of the above court ruling to the case on hand, the CBDT has the power to condone the delay in filing the return of income of Mr. Rajesh and permit carry forward of business loss of ` 1 lakh, since the delay of one hour was due to a genuine and justifiable reason i.e., network problem while e-filing the return.

Question 2

Examine the correctness of the statement "the jurisdiction of an Assessing Officer cannot be objected by the assessee".

Answer

According to section 124(3), the assessee can raise a question as to the jurisdiction of an Assessing Officer within the prescribed time limit as under:

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(i) **where a return has been filed** under section 139(1) then, within one month from the date of service of notice under section 142(1) or section 143(2) or before the completion of assessment, whichever is earlier.

(ii) **where no return has been filed,** then, within the expiry of time allowed by the notice under section 142(1) or section 148 for filing the return or within the time allowed in show cause notice issued seeking as to why a best judgment assessment under section 144 should not be made, whichever is earlier.

(iii) where search is initiated under section 132 or books of accounts, other documents or any assets are requisitioned under section 132A, within one month from the date on which he was served with a notice under section 153A(1) or 153C(2) or before the completion of assessment, whichever is earlier.

Where the assessee calls in question the jurisdiction of an Assessing Officer and the Assessing Officer is not satisfied with such claim, he shall refer the matter for determination by the Principal Director General or Director General or Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner before the assessment is made.

Therefore, in view of the above provisions, the statement that "the jurisdiction of an Assessing Officer cannot be objected by the assessee" is not correct.

Question 3

The Director General of Income Tax after getting the information that Mr. Mogambo is in possession of unaccounted cash of ` 50 lacs, issued orders by invoking powers vested in him as per section 131(1A), for its seizure. Is the order for seizure of cash issued by the Director General of Income Tax correct? If not, does the Director General of Income Tax have any other power to seize such cash?

Answer

The powers under section 131(1A) deal with power of discovery and production of evidence. They do not confer the power of seizure of cash or any asset. The Director General, for the purposes of making an enquiry or investigation relating to any income concealed or likely to be concealed by any person or class of persons within his jurisdiction, shall be competent to exercise powers conferred under section 131(1), which confine to discovery and inspection, enforcing attendance, compelling the production of books of account and other documents and issuing commissions. Thus, the power of seizure of unaccounted cash is not one of the powers conferred on the Director General under section 131(1A).

However, under section 132(1), the Director General has the power to authorize any Additional Director or Additional Commissioner or Joint Director or Joint Commissioner etc. to seize money found as a result of search [Clause (iii) of section 132(1)], if he has reason to believe that any person is in possession of any money which represents wholly or partly income which has not been disclosed [Clause (c) of section 132(1)]. Therefore, the proper course open to the Director General is to exercise his power under section

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132(1) and authorize the Officers concerned to enter the premises where the cash is kept by Mr. Mogambo and seize such unaccounted cash.

Question 4

The premises of Ganesh were subjected to a search under section 132 of the Act. The search was authorized and the warrant was signed by the Joint Commissioner of Income-tax having jurisdiction over the assessee, consequent to information in his possession. The assessee challenged the validity of search on the ground that section 132(1) does not empower Joint Commissioner to authorise a search under the Act. Decide the correctness of the contention raised by the assessee.

Answer

Under section 132(1), the income-tax authorities listed therein are empowered to authorise other income-tax authorities to conduct search and seizure operations. The authorities empowered to issue authorization include such Additional Director, Additional Commissioner, Joint Director and Joint Commissioner as are empowered by the CBDT to do so.

However, a Joint Commissioner can issue warrant of authorization only if he has been specifically empowered to do so by the CBDT. Therefore, only if the Joint Commissioner has not been specifically empowered by the CBDT to do so, the contention of the assessee would hold good.

Question 5

Examine whether the information regarding possession of unexplained assets and income received from the Central Bureau of Investigation, a Government agency, can constitute "information" for action under section 132. Discuss.

Answer

As per section 132(1)(c), authorization for search and seizure can take place if the authority, in consequence of information in his possession, has reason to believe that any person is in possession of money, bullion, jewellery or other valuable article or thing and these assets represent, either wholly or partly, income or property which has not been, or would not be disclosed by such person for the purposes of this Act. In the absence of such information, a search cannot be validly authorized.

The Apex Court in UOI v Ajit Jain [2003] 260 ITR 80 has held that mere intimation by the CBI that money was found in the possession of the assessee, which according to the CBI was undisclosed, without something more, does not constitute "information" within the meaning of section 132, on the basis of which a search warrant could be issued. Consequently, the Supreme Court held that the search conducted on this basis and the assessment made pursuant to such search was not valid.

Question 6

In the course of search operations under section 132 in the month of July, 2017, a tax payer makes a declaration under section 132(4) on the earning of income not disclosed in respect of

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P.Y.2016-17. Can that statement save the tax payer from a levy of penalty, if he is yet to file his return of income for A.Y.2017-18?

Answer

Since the search is conducted on or after 15.12.2016, and return is yet to be filed for the P.Y. 2016-17, the penalty would be as follows

(1) penalty@30%, 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, and furnishes the return of income for the specified previous year declaring such 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).

(2) penalty@60% in any other case.

Therefore, even if the tax payer furnishes the statement under section 132(4), penalty@30% of undisclosed income of the specified previous year would be attracted under section 271AAB.

Question 7

Cash of ` 25 lacs was seized on 12.9.2017 in a search conducted as per section 132 of the Act. The assessee moved an application on 27.10.2017 to release such cash after explaining the sources thereof, which was turned down by the department. The assessee seeks your opinion on, the following issues:

(i) Can the department withhold the explained money?

(ii) If yes, then to what extent and upto what period?

Answer

The proviso to section 132B(1)(i) provides that 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 the nature and source of acquisition of the asset is explained to the satisfaction of the Assessing Officer, then, the Assessing Officer may, with the prior approval of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner, release the asset after recovering the existing liability under the Income-tax Act, 1961, etc. out of such asset. 'Existing liability', however, does not include advance tax payable. Such asset or portion thereof has to be released within 120 days from the date on which the last of the authorizations for search under section 132 was executed.

In this case, since the application was made to the Assessing Officer within the 30 day period the amount of existing liability may be recovered out of the asset and the balance may be released within 120 days from the date on which the last of the authorizations for search under section 132 was executed.

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Note: It may be noted that one of the conditions mentioned above for release of an asset is that the nature and source of acquisition of the asset should be explained to the satisfaction of the Assessing Officer. However, in this case, it has been given that the assessee's application for release of the asset, explaining the sources thereof, was turned down by the Department. If the application was turned down by the Department due to the reason that it was not satisfied with the explanation given by the assessee as to the nature and source of acquisition of the asset, then, the asset (in this case, cash) cannot be released, since the condition mentioned above is not satisfied.

Question 8

The business premises of Ram Bharose Ltd. and the residence of two of its directors at Delhi were searched under section 132 by the DDI, Delhi. The search was concluded on 9.8.2017 and following were also seized besides other papers and records:

(i) Papers found in the drawer of an accountant relating to Shri Krishna Ltd., Mumbai indicating details of various business transactions. However, Ram Bharose Ltd. is not having any direct or indirect connection of any nature with these transactions and Shri Krishna Ltd., Mumbai and its directors.

(ii) Jewellery worth ` 5 lacs from the bed room of one of the director, which was claimed by him to be of his married daughter.

(iii) Papers recording certain transactions of income and expenses having direct nexus with the business of the company for the period from 16.4.2013 to date of search. It was admitted by the director that the transactions recorded in such papers have not been incorporated in the books.

You are required to answer on the basis of aforesaid and the provisions of Act, following questions:

(a) What action the DDI shall be taking in respect of the seized papers relating to Shri Krishna Ltd., Mumbai?

(b) Whether the contention raised by the director as to jewellery found from his bed-room will be acceptable?

(c) What presumption shall be drawn in respect of the papers which indicate transactions not recorded in the books?

(d) Can the company move an application for settlement of case as per Chapter XIX-A of the Act?

Answer

(a) The authorised officer being DDI, Delhi is not having any jurisdiction over Shri Krishna Ltd., Mumbai, and therefore as per section 132(9A), the papers seized relating to this company shall be handed over by him to the Assessing Officer having jurisdiction over Shri Krishna Ltd., Mumbai within a period of 60 days from the date on which the last of the authorisations for search was executed for taking further necessary action thereon.

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(b) The contention raised by the Director will not be acceptable because as per the provisions of sub-section (4A)(i) of section 132, where any books of account, other documents, money, bullion, jewellery or other valuables are found in the possession or control of any person in the course of search, then, in respect thereof, it may be presumed that the same belongs to that person.

(c) As per section 132(4A), the presumptions in respect of the papers, indicating transactions not recorded in the books but having direct nexus with the business of the company, are that the same belong to the company, contents of such papers are true and the handwriting in which the same are written is/are of the persons(s) whose premises have been searched.

(d) As per clause (iiia) in the Explanation to section 245A, the assessee can approach the Settlement Commission at any time after the date of issue of notice under section 153A or section 153C initiating the assessment proceedings. Therefore, an application can be made to the Settlement Commission where search has been initiated under section 132 followed by assessment under section 153A or section 153C.

The proviso to section 245C(1) specifies the monetary limit for making application for settlement of cases, in respect of search cases. Accordingly, the additional amount of income- tax payable on the income disclosed in the application must exceed ` 50 lacs so that application for settlement of the case is eligible for admission.

Question 9

In April, 2017, the business premises of Priyanka Ravi were searched under section 132 by the DDI, Delhi. The search was concluded on 30.04.2017 and following assets/documents were found which were not recorded in her books of accounts :

- Jewellery of ` 25 Lacs pertaining to P.Y. 2012-13

- Agreement for purchase of land which contains the payment of advance of ` 35 Lacs in cash in the P.Y.2011-12

- Shares purchased in the P.Y.2009-10 and in the P.Y.2010-11 totaling to ` 40 Lacs.

- Paper containing the payment of ` 15 Lacs in the P.Y.2007-08 and ` 10 Lacs in P.Y.2006-07 to a contractor for construction of residential house.

Accordingly, Assessing Officer has issued the notice for all the previous years from P.Y.2006-07 to P.Y.2016-17 under section 153A.

However, Miss Priyanka Ravi contented that the Assessing Officer cannot issue the notice under section 153A beyond six assessment years immediately preceding the assessment year relevant to the previous year in which the search was conducted under section 132 i.e. notice can be issued upto A.Y.2012-13 (P.Y. 2011-12).

Discuss about the correctness of action of Assessing Officer and the contention of Miss Priyanka Ravi.

Answer

As per the amendment to section 153A(1) by the Finance Act, 2017, issuance of notice and

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assessment or reassessment under the said section can also be made for an assessment year preceding the assessment year relevant to the previous year in which search is conducted or requisition is made which falls **beyond six assessment years** but **not beyond ten assessment years** from the assessment year relevant to the previous year in which search is conducted or requisition is made, provided that -

(i) the Assessing Officer has in his possession books of account or other documents or evidence which reveal that the income which has escaped assessment amounts to or is likely to amount to **fifty lakh rupees or more in one year or in aggregate in the relevant assessment years;**

(ii) such income escaping assessment is represented in the form of asset which **shall include immovable property being land or building or both, shares and securities, deposits in bank account, loans and advances;**

(iii) the income escaping assessment or part thereof relates to such year or years; and

(iv) search under section 132 is initiated or requisition under section 132A is made on or after the 1-4-2017.

In the light of the above amended provision, the Assessing Officer can issue the notice u/s 153A beyond six assessment years but not beyond ten assessment years from the assessment year relevant to the previous year in which search is conducted or requisition is made. Thus, in the given case, the Assessing Officer can issue notice under section 153A upto A.Y.2008-09 as she,

a. has in his possession, documents or evidence which reveals the escaped assessment amounts to ` 55 lacs in aggregate during the relevant four assessment years i.e. from AY 2008-09 to AY 2011-12

b. such income escaping assessment represents in the form of assets which includes ` 40 lacs being Shares purchased in P.Y. 2009-10 and P.Y. 2010-11 **plus** ` 15 lacs being payment to contractor for construction of residential house in PY 2007-08 **(**payment of ` 10 lacs relevant to PY 2006-07 cannot be included as it is beyond ten assessment years)

c. search was conducted on 30.04.2017 i.e. after 01.04.2017.

Hence, the contention of Miss. Priyanka Ravi that the Assessing Officer cannot issue the notice under section 153A beyond six assessment years immediately preceding the assessment year relevant to the previous year in which the search was conducted under section 132 **is incorrect**.

The action of Assessing Officer is **partly correct** as it is possible to him to issue notice beyond six assessment years but not beyond ten assessment years from the assessment year relevant to the previous year in which search is conducted or requisition is made. Thus, he cannot issue the notice under section 153A for the A.Y.2007-08.

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Note – *It may be noted that as per the amendment to sub-section (1) of section 153A of Finance Act, 2017, the notice can be issued beyond six assessment years in respect of income escaping assessment which is represented in the form of asset which shall include immovable property being land or building or both, shares and securities, deposits in bank account, loans and advances. It means, the list of assets is exhaustive. If the income escaping assessment is in the form of any other assets like jewellery, bullion, etc. then no notice can be issued even if other conditions are fulfilled.*

Question 10

In the course of search on 25.03.2018, assets were seized. Examine the procedure laid down to deal with such seized assets under the Act.

Answer

Section 132B of the Income-tax Act, 1961 deals with the application of assets seized under section 132. Such assets will be first applied towards the existing liability under the Income-tax Act, 1961, etc. 'Existing liability', however, does not include advance tax payable. Further, the amount of liability determined on completion of search assessment (including any penalty levied or interest payable in connection with such assessment) and in respect of which the assessee is in default or deemed to be in default, may be recovered out of such assets.

Where the nature and source of acquisition of such seized assets is explained to the satisfaction of the Assessing Officer, the amount of any existing liability mentioned in para 1 above may be recovered out of such asset and the remaining portion, if any, of the asset may be released, with the prior approval of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner, as the case may be. The release must be made within 120 days from the date on which the last of the authorisations for search under section 132 or for requisition under section 132A was executed. The assets would be released to the person from whose custody they were seized.

When the assets consist of solely of money, or partly of money and partly of other assets, the Assessing Officer may apply such money in the discharge of the liabilities referred to in para 1 above and the assessee shall be discharged of such liability to the extent of the money so applied. However, the assets other than money may also be applied for the discharge of such liabilities if the complete recovery could not be made from the money seized or the money seized was not sufficient.

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SIGNIFICANT SELECT CASES

1. Can the assessee's application, for adjustment of tax liability on income surrendered during search by sale of seized gold bars, be entertained where assessment has not been completed?

Hemant Kumar Sindhi & Another v. CIT (2014) 364 ITR 555 (All)

Facts of the case: Consequent to a search in the premises of the assessee, some gold bars were seized from the locker. The assessee voluntarily disclosed some income during the course of search. The assessee filed an application for sale of the gold bars and adjustment of tax liability on undisclosed income out of the sale proceeds. This would obviate his liability to pay interest under sections 234B and 234C. The Assessing Officer dismissed the application on the reasoning that only when the assessment is completed and tax demand is crystallized, can recovery be initiated by the sale of gold bars. The assessee filed a writ contesting the dismissal of application by the Assessing Officer.

High Court's Observations: The High Court observed that section 132B(1)(i) uses the expression "the amount of any existing liability" and "the amount of the liability determined". The words "existing liability" postulates a liability that is crystallized by adjudication; Likewise, "a liability is determined" only on completion of the assessment. **Until the assessment is complete, it cannot be postulated that a liability has been crystallized.**

As per the first proviso to section 132B(1)(i), the assessee may make an application to the Assessing Officer for release of the assets seized. However, he has to explain the nature and source of acquisition of the asset to the satisfaction of the Assessing Officer. It is not the ipse dixit of the assessee but the satisfaction of the Assessing Officer on the basis of the explanation tendered by the assessee which is material.

High Court's Decision: The High Court, accordingly, held that the Assessing Officer was justified in his conclusion that it is only when the liability is determined on the completion of assessment that it would stand crystallized and in pursuance of which a demand can be raised and recovery can be initiated. Therefore, in the present case, the first proviso to section 132B(1)(i) would not be attracted. The High Court, thus, dismissed the writ petition.

2. Where no proceeding is pending against a person, can the Assessing Officer call for information under section 133(6), which is useful or relevant to any enquiry, with the permission of Director or Commissioner?

Kathiroor Service Co-operative Bank Ltd. v. CIT (CIB) (2014) 360 ITR 0243 (SC)

Facts of the case: The Assessing Officer, with the prior approval of the Commissioner, issued notice under section 133(6) to the assessee, a co-operative society engaged in banking business, calling for general information regarding details of all persons (whether resident or

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non-resident) who had made (a) cash transactions of `1 lakh and above in any account, and/or (b) time deposits of ` 1 lakh or above, for the period of three years between April 1, 2005, and March 31, 2008, expressly stating therein that failure to furnish the information would attract penal consequences.

The assessee objected to the said notice, inter alia, on the ground that such notice seeking for information which is unrelated to any existing or pending proceeding against the assessee could not be issued under the provisions of the Act.

Supreme Court's Observations: The Supreme Court observed that the Assessing Officer has been empowered to requisition information which will be useful for or relevant to **any enquiry** or proceeding under the Income-tax Act, 1961 in the case of any person. However, an income-tax authority below the rank of the Director or Commissioner can exercise this power in respect of an **enquiry** in a case where no proceeding is pending, only with the prior approval of the Director or the Commissioner.

Supreme Court's Decision: The Supreme Court held that information of general nature could be called for from banks. In this case, since notices have been issued after obtaining approval of the Commissioner, the assessing authority had not erred in issuing the notices to assessees requiring them to furnish information regarding account holders with cash transactions or deposits of more than ` 1 lakh. The Supreme Court, therefore, held that for such enquiry under section 133(6), the notices could be validly issued by the assessing authority.

Note – The Finance Act, 2017 has amended the second proviso to section 133 to provide that the power in respect of an inquiry, in a case where no proceeding is pending, can be exercised by the Joint Director, Deputy Director and Assistant Director, without the prior approval of the Principal Director/Director/Principal Commissioner/Commissioner.

3. Is the requirement to grant a reasonable opportunity of being heard, stipulated under section 127(1), mandatory in nature?

Sahara Hospitality Ltd. v. CIT (2013) 352 ITR 38 (Bom.)

High Court's Observations: On this issue, the Bombay High Court observed that the provisions of section 127(1) stipulate, inter alia, that the income tax authority mentioned therein **may** give an opportunity of being heard to the assessee, wherever it is possible to do so, and after recording his reasons for doing so, transfer any case from one or more Assessing Officers subordinate to him to any other Assessing Officer or officers subordinate to him.

High Court's Decision: The Bombay High Court held that the word "may" used in this section should be read as "shall" and such income-tax authority has to mandatorily give a reasonable opportunity of being heard to the assessee, wherever possible to do so, and thereafter, record the reasons for taking any action under the said section. "Reasonable opportunity" can only be dispensed with in a case where it is not possible to provide such opportunity. In such a case also, the authority should record its reasons for making the transfer, even though no opportunity was given to the assessee. The

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discretion of the authority is only to consider as to what is a reasonable opportunity in a given case and whether it is possible to give such an opportunity to the assessee or not. The authority cannot deny a reasonable opportunity of being heard to the assessee, wherever it is possible to do so.

4. Does the Central Board of Direct Taxes (CBDT) have the power under section 119(2)(b) to condone the delay in filing return of income?

Lodhi Property Company Ltd. v. Under Secretary, (ITA-II), Department of Revenue (2010) 323 ITR 441 (Del.)

Facts of the case: The assessee filed his return of income, which contains a claim for carry forward of losses, a day after the due date. The delay of one day in filing the return of income was due to the fact that the assessee had not reached the Central Revenue Building on time because he was sent from one room to the other and by the time he reached the room where his return was to be accepted, it was already 6.00 p.m. and he was told that the return would not be accepted because the counter had been closed. These circumstances were recorded in the letter along with the return of income delivered to the office of the Deputy Commissioner of Income-tax on the very next day. Later on, the CBDT, by a non-speaking order, rejected the request of the assessee for condonation of delay in filing the return of income under section 119.

Issue: The issue under consideration is whether the CBDT has the power under section 119(2)(b) to condone the delay in filing return of income.

High Court's Decision: The High Court held that the Board has the power to condone the delay in case of a return which was filed late and where a claim for carry forward of losses was made. The delay was only one day and the assessee had shown sufficient reason for the delay of one day in filing the return of income. If the delay is not condoned, it would cause genuine hardship to the petitioner. Therefore, the Court held that the delay of one day in filing of the return has to be condoned.

***Note** – Section 119(2)(b) empowers the CBDT to authorise any income tax authority to admit an application or claim for any exemption, deduction, refund or **any other relief under the Act** after the expiry of the period specified under the Act, to avoid genuine hardship in any case or class of cases. The claim for carry forward of loss in case of a loss return is relatable to a claim arising under the category of any other relief available under the Act. Therefore, the CBDT has the power to condone delay in filing of such loss return due to genuine reasons.*

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Illustration

The assessment of Mr. Hari for A.Y.2010-11 was made on 28.3.2012 making an addition of Rs.3,25,000 for a certain income received during the P.Y.2009-10. The assessee contested the addition before Commissioner (Appeals) but lost the case. The Appellate Tribunal passed an order on 26.2.2017 holding that the said income was not taxable in the P.Y.2009-10 but the same was taxable in the year of accrual, being P.Y.2004-05 relevant to A.Y.2005-06. The Assessing Officer issued notice under section 148 for A.Y.2005-06 in March 2017 bringing to tax the sum of Rs.3,25,000. Is the notice valid?

Would your answer change if in the said case, the assessment order for A.Y.2010-11 was made on 4.4.2012 instead of 28.3.2012?

Solution

Section 149 requires issue of notice under section 148 within a period of 6 years from the end of the relevant assessment year, where income escaping assessment exceeds Rs.1 lakh. Accordingly, in respect of A.Y.2010-11, notice can be issued upto 31.3.2017. Section 150(1) enables issue of notice at any time to give effect to a finding contained in an appellate order. However, this is subject to the provisions of section 150(2), which places a restriction that if on the date of passing of the order which was the subject-matter of appeal, no notice could have been issued, then, such notice cannot be issued by virtue of the enabling provision contained in section 150(1).

In this case, the income was taxable in the A.Y.2005-06 as per the order of the Appellate Tribunal. The six year time limit, in this case, expires on 31.3.2012. Since the original assessment in respect of such income was made on 28.3.2012, the notice issued under section 148 consequent to the Appellate Tribunal order is valid.

Had the assessment order for A.Y.2010-11 been made on 4.4.2012 (instead of 28.3.2012), then the same would have been outside the six year time limit from A.Y.2005-06. Hence, since notice could not have been issued at that point of time, it cannot be now issued invoking the provisions of section 150(1).

EXERCISE

Question 1

Teachwell Education is a trust approved under section 10(23C)(vi) which runs various educational institutions. During the course of assessment under section 143(3), the Assessing Officer finds that the trust has carried out its activities in contravention of the section under which it was approved for exemption. Hence, the Assessing Officer wants to pass an order without giving exemption under section 10, which the assessee objects. You are required to examine the following with respect to the provisions of Income-tax Act, 1961.

(a) Whether the Assessing Officer can pass an order without giving exemption under section 10?

(b) Can the Assessing Officer get any additional time limit in completing this assessment?

Answer

(a) As per the first proviso to section 143(3), in the case of an institution approved under, inter alia, section 10(23C)(vi), which is required to furnish the return of income under section 139(4C), the Assessing Officer shall not pass an order of assessment under section 143(3) without giving

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effect to the provisions of section 10, unless he is of the view that the activities of the institution are being carried on in contravention to the provisions of that section and:

(1) he has intimated the Central Government or the prescribed authority, which had earlier approved the concerned institution, about the contravention of the relevant provisions by the institution; and

(2) the approval granted to such institution has been withdrawn or notification in that respect has been rescinded.

Therefore, in the aforesaid case, the Assessing Officer can pass an assessment order without giving exemption under section 10 to Teachwell Education, which is an educational institution approved under section 10(23C)(vi), only if he has intimated the contravention made by Teachwell Education to the Central Government or the prescribed authority, as the case may be, and its approval under section 10(23C)(vi) is withdrawn.

(b) As per Explanation 1 to section 153, in case the Assessing Officer intimates the contravention of provisions of section 10(23C)(vi) to the Central Government or the prescribed authority, the period commencing from the date of intimation of such contravention by the Assessing Officer and ending on the date on which the copy of the order of withdrawing the approval under section 10(23C)(vi) is received by the Assessing Officer, shall be excluded for computing the period of limitation for completing the assessment.

Further, in case the time limit available to the Assessing Officer for passing an assessment order, after such exclusion, is less than 60 days, such remaining period of assessment shall be deemed to have been extended to 60 days.

Therefore, the Assessing Officer will get the above mentioned additional time for completing the assessment of Teachwell Education.

Question 2

State with reasons whether return of income is to be filed in the following cases for the Assessment Year 2018-19:

(i) Mr. X, a resident individual, aged 80 years, has a total income of Rs.2,85,000. He has claimed deduction of Rs.1,50,000 under section 80C and exemption of Rs.1,20,000 under section 10(38).

(ii) ABC, a partnership firm, has a loss of Rs.10,000 during the previous year 2017-18.

(iii) A registered association, eligible for exemption under section 10(23B), has income from house property of Rs.2,60,000.

(iv) Mr. Y, aged 45 years, an employee of ABC (P) Ltd, draws a salary of Rs.4,90,000 and has income from fixed deposits with bank of Rs.10,000.

Answer

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S. No.	Is filing of return required?	Reason
(i)	Yes	As per the provisions of section 139(1), every person, whose total income without giving effect to the provisions of Chapter VI-A and exemption under section 10(38) exceeds the maximum amount not chargeable to tax, is required to furnish the return of income for the relevant assessment year on or before the due date. The gross total income of Mr. X before giving effect to the exemption of Rs.1,20,000 under section 10(38) and deduction of Rs.1,50,000 under section 80C is Rs.5,55,000, which exceeds the basic exemption limit of Rs.5,00,000 applicable to an individual aged 80 years or more. Therefore, Mr. X has to furnish his return of income for the A.Y. 2018-19.
(ii)	Yes	As per section 139(1), it is mandatory for a firm to furnish its return of income or loss on or before the specified due date. Therefore, M/s ABC has to furnish its return of loss for the A.Y. 2018-19 on or before the due date.
(iii)	Yes	As per section 139(4C), every institution referred to, inter alia, in section 10(23B), whose total income without giving effect to the provisions of section 10 exceeds the maximum amount not chargeable
		to tax, is required to furnish the return of income for the relevant assessment year on or before the due date. In the above case, the registered association has income from house property of Rs.2,60,000 before exemption under section 10, which exceeds the basic exemption limit of Rs.2,50,000. Therefore, it is under an obligation to furnish its return of income for the A.Y. 2018-19.
(iv)	Yes	As per the provisions of section 139(1), every person, whose gross total income exceeds the maximum amount not chargeable to tax, is required to furnish the return of income for the relevant assessment year on or before the due date. The gross total income of Mr. Y is Rs.5,00,000 (Rs.4,90,000 + Rs.10,000) which exceeds the basic exemption limit of Rs.2,50,000 applicable to an individual. Therefore, Mr. Y has to furnish his return of income for the A.Y. 2018-19.

Question 3

The Assessing Officer issued a notice under section 142(1) on the assessee on 24th December, 2017 calling upon him to file return of income for Assessment Year 2017-18. In response to the said notice, the assessee furnished a return of loss and claimed carry forward of business loss and unabsorbed depreciation. State whether the assessee would be entitled to carry forward as claimed in the return.

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Answer

As per the provisions of section 139(3), any person who has sustained loss under the head 'Profit and gains of business or profession' is allowed to carry forward such a loss under section 72(1) or section 73(2), only if he has filed the return of loss within the time allowed under section 139(1). Also, the provisions of section 80 specify that a loss which has not been determined as per the return filed under section 139(3) shall not be allowed to be carried forward and set-off under, inter alia, section 72(1) (relating to business loss) or section 73(2) (losses in speculation business) or section 74(1) (loss under the head "Capital gains") or section 74A(3) (loss from the activity or owning and maintaining race horses) or section 73A (loss relating to a "specified business"). However, there is no such condition for carry forward of unabsorbed depreciation under section 32.

In the given case, the assessee has filed its return of loss in response to notice under section 142(1). As per the provisions stated above, the return filed by the assessee in response to notice under section 142(1) is a belated return and therefore, the benefit of carry forward of business loss under section 72(1) or section 73(2) or section 73A shall not be available. The assessee shall, however be entitled to carry forward the unabsorbed depreciation as per provisions of section 32(2).

Question 4

The regular assessment of MNO Ltd. for the Assessment Year 2016-17 was completed under section 143(3) on 13th March, 2018. There was an audit objection by the Revenue Audit team that interest on loan should be disallowed partly as there was diversion of borrowed fund to sister concern without charge of interest.

Based on the above facts:

(i) State, with reasons, whether the Assessing Officer can issue notice under section 148 on the basis of audit objection of the Revenue Audit team.

(ii) If the action stated in (i) above is not permitted, what is the option open to the Revenue Department to deal with the said audit objection?

Answer

(i) Section 147 states that if the Assessing Officer has **reason to believe that any income chargeable to tax has escaped assessment for any assessment year**, he may assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice subsequently in the course of the proceedings under this section.

The Assessing Officer should, therefore, have reason to believe that income chargeable to tax has escaped assessment. The belief should be that of the Assessing Officer and not of the revenue audit team.

Further, the Income-tax Act, 1961 does not confer jurisdiction on the Assessing Officer to change its opinion on the interpretation of a particular provision earlier adopted by it. If the issue had already been considered earlier during the course of scrutiny assessment and the Assessing Officer had come to a conclusion that no disallowance of interest paid by the assessee is required, even though loans had been given to sister concern without any interest, the same issue cannot be the basis of reassessment, merely because the revenue audit team takes a different

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view.

The Supreme Court, in ACIT v. ICICI Securities Primary Dealership Ltd. (2012) 348 ITR 299, held that re-opening of the assessment by the Assessing Officer on the ground of change of opinion is not valid.

Therefore, the Assessing Officer cannot issue notice under section 148 on the basis of audit objection of the Revenue Audit team.

If the Assessing Officer has acted only under compulsion of the audit party and not independently, the action of reopening would be invalid.

(ii) The option open to the Revenue is initiation of proceedings under 263, by the jurisdictional Commissioner. He has the power to call for and examine the records, if he is of the opinion that the order passed by the Assessing Officer under section 143(3) is erroneous in so far as it is prejudicial to the interests of the Revenue.

However, where the Assessing Officer has considered the issue in the original assessment and come to a conclusion that no disallowance of interest is called for, the Commissioner cannot initiate revisionary proceedings, merely because he holds a different view. Only where the view taken by the Assessing Officer is unsustainable in law, the Commissioner will be justified in initiating the revisionary proceedings under section 263. It was so held in CIT vs. Sohana Woollen Mills (2008) 296 ITR 238 (P & H).

Mere audit objection and possibility of a different view are not sufficient to conclude that the order of the Assessing Officer is erroneous or prejudicial to the interest of revenue.

Question 5

State whether the following assessees have to file return of income and if so, the due date for the assessment year 2018-19:

(i) A registered trade union having income from let out property of Rs.1,00,000.

(ii) A public trust hospital having an aggregate annual receipt of Rs.200 lacs and availing exemption under section 10(23C)(via) with total income of Rs.1,10,000.

Answer

(i) A registered trade union is having income from house property, which is exempt under section 10(24).

Section 139(4C) mandates filing of return only when the total income exceeds the maximum amount which is not chargeable to tax without giving effect to the provisions of section 10. In this case, even without giving effect to section 10(24), the total income of the registered trade union is below basic exemption limit and therefore, there is no mandatory requirement to file the return of income.

(ii) The quantum of exemption under section 10(23C)(via) is not given in the question.

If the total income of the public trust hospital, without giving effect to the exemption under section 10(23C)(via), is less than the basic exemption limit of Rs.2,50,000, the trust need not file its return of income. However, if the total income without giving effect to the exemption under

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section 10(23C)(via) exceeds Rs.2,50,000, the trust has to file its return of income by 30th September, 2018.

Question 6

Dishant received a notice under section 148 from the Assessing Officer for A.Y. 2014-15 on the ground that depreciation on certain assets was allowed in excess. The Assessing Officer recorded the reason for reopening. The original assessment was completed under section 143(3). In course of reassessment proceeding, the Assessing Officer also disallowed certain sum under section 14A in respect of expenses purported to be in relation to dividend from companies and tax-free interest. However, the Assessing Officer did not record the reason for applying the provisions of section 147 in respect of the issue of disallowance under section 14A and passed the order disallowing the excess depreciation and also certain sum under section 14A. Is there any infirmity in the order passed by the Assessing Officer?

Answer

Explanation 3 to section 147 permits the Assessing Officer to 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 section 147, even though the reason for such issue does not form part of the reasons recorded under section 148(2).

Therefore, in the instant case, the Assessing Officer has the power to disallow expenses under section 14A in addition to disallowing excess depreciation for which notice under section 148 was issued even though the reason for issue relating to disallowance under section 14A was not recorded under section 148(2).

Hence, there is no deficiency in the order passed by the Assessing Officer.

Question 7

In the proceedings initiated under section 153A, the assessment order passed in respect of Mr. Simbu pertaining to a particular assessment year was annulled by the Income-tax Appellate Tribunal in its order passed on 28.1.2018. The same was received on 28.2.2018 by the jurisdictional Commissioner of Income-tax. Does the Department have any power to complete the assessment subsequent to such annulment? If yes, within what time limit?

Answer

As per section 153A(2), if any proceedings 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 Principal Commissioner or Commissioner. If the order of annulment is set aside, such revival shall cease to have effect [Sub-section (2) of section 153A].

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 specified in section 153B(1) [i.e., 21 months from the end of the financial year in which the last of authorisations for search or requisition was executed], whichever is later.

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Question 8

What will be the consequences when Mr. Raghav made payment of Rs.75,000 in cash to a travel agent for his travel to Saudi Arabia to be undertaken for business purposes by quoting intentionally the wrong PAN? Would your answer be different if such cash payment was made for his travel to Nepal, instead of Saudi Arabia?

Answer

If a person who is required to quote his permanent account number in any document referred to in section 139A(5)(c), quotes a number which is false, and which he either knows or believes to be false or does not believe to be true, the Assessing Officer may direct that such a person shall pay by way of penalty a sum of Rs.10,000 under section 272B(2).

In the given case, if Mr. Raghav travels to Saudi Arabia and pays his travel agent cash in excess of Rs.50,000, such a transaction is covered by section 139A(5)(c) read with Rule 114B and therefore, Mr. Raghav has to quote his PAN. Since Mr. Raghav has misquoted his PAN, penalty under section 272B(2) is leviable. Mr. Raghav has to be given an opportunity of being heard in the matter. If Mr. Raghav is not able to prove that there was a reasonable cause for the said failure, penalty under section 272B(2) would be imposable.

The answer would remain the same even if such cash payment was made for his travel to Nepal.

Question 9

For facilitating expeditious resolution of disputes relating to international transactions involving transfer pricing and foreign companies, the Income-tax Act, 1961, has provided for "alternate dispute resolution mechanism". In this context, you are required to answer the following:

(i) What meanings have been assigned to "dispute resolution panel" and the "eligible assessee" under this mechanism?

(ii) When can a grievance for resolution be filed by an assessee?

(iii) What evidences are being considered by the panel to redress the grievance of the assessee?

Answer

(i) The term "Dispute Resolution Panel" has been defined to mean a collegium comprising of three Principal Commissioners or Commissioners of Income-tax constituted by the Board for this purpose.

The term "Eligible Assessee" means any person in whose case the variation referred to in section 144C(1) in the income or loss returned arises as a consequence of the order of the Transfer Pricing Officer passed under section 92CA(3) and any foreign company.

(ii) The Assessing Officer shall forward a draft of the proposed order of assessment to the eligible assessee and on receipt of such order, the eligible assessee shall, within thirty days of the receipt of the draft order, file his acceptance of the variations to the Assessing Officer or file his objections, if any, to such variation, with the Dispute Resolution Panel and the Assessing Officer.

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(iii) The Dispute Resolution Panel shall, in a case where any objections are received, take into consideration:-

(a) the draft order

(b) the objections filed by the assessee

(c) the evidence furnished by the assessee

(d) the report, if any, of the Assessing Officer, Valuation Officer or Transfer Pricing Officer or any other authority

(e) the records relating to the draft order

(f) the evidence collected by, or caused to be collected by it

(g) the result of any enquiry made by or caused to the made by it,

and issue such directions, as it thinks fit, for the guidance of the Assessing Officer to enable him to complete the assessment.

Question 10

The Assessing Officer has the power to make an assessment to the best of his judgment, in certain situations. What are they?

Answer

Under section 144, the Assessing Officer, after taking into account all relevant material which he has gathered, is under an obligation to make an assessment of the total income or loss to the best of his judgment and determine the sum payable by the assessee in the following cases –

(1) Where any person fails to make the return under section 139(1) and has not filed a belated return under section 139(4) or a revised return under section 139(5).

(2) Where any person fails to comply with all the terms of a notice issued under section 142(1) or fails to comply with a direction issued under section 142(2A) for getting the accounts audited.

(3) Where any person, having made a return, fails to comply with all the terms of a notice issued under section 143(2).

Further, section 145(3) of the Income-tax Act, 1961 permits the Assessing Officer to make an assessment in the manner provided in section 144:

(i) where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee; or

(ii) where the method of accounting under section 145(1) has not been regularly followed by the assessee;

(iii) where the income has not been computed in accordance with "Income Computation and Disclosure Standards" notified by the Central Government under section 145(2).

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Question 11

The assessment of CNK Associates, a partnership firm, for the assessment year 2015-16 was made under section 143(3) on 31st July, 2017. The Assessing Officer made two additions to the income of the assessee viz. (a) addition of Rs.2 lacs under section 40(a)(ia) due to non-furnishing of evidence of payment of TDS and (ii) addition of Rs.5 lacs on account of unexplained cash credit. The assessee contested addition on account of unexplained cash credit in appeal to the Commissioner (Appeals). The appeal was decided in January, 2017 against the assessee. The assessee approaches you for your suggestion as to whether it should apply for revision to the Commissioner under section 264 or rectification to the Assessing Officer under section 154 as regards disallowance under section 40(a)(ia). What should be your suggestion?

Answer

The Commissioner cannot exercise his power of revision under section 264 where the order sought to be revised has been made the subject of an appeal to the Commissioner (Appeals) or to the Appellate Tribunal [Section 264(4)], even if the relief claimed in the revision is different from the relief claimed in the appeal. This was the view of the Supreme Court in the case of Hindustan Aeronautics Limited vs. CIT (2000) 243 ITR 808. It is not open to the assessee to seek recourse to revision under section 264 after the appeal is decided. Therefore, although the matter of addition of Rs.2 lacs under section 40(a)(ia) was not taken before the Commissioner (Appeals), the assessee, CNK Associates cannot apply for revision under section 264 in respect of the same.

Under section 154(1A), where any matter had been considered and decided in any proceeding by way of appeal or revision, rectification of such matter cannot be done by the Assessing Officer. However, in respect of the matter which has not been considered and decided in the appeal or revision, the order of the Assessing Officer can be rectified under section 154. Thus, the assessee can apply to the Assessing Officer for rectification of the order in respect of addition under section 40(a)(ia), as this matter has not been considered and decided in any proceeding by way of appeal or revision.

In view of above, the assessee, CNK Associates should seek rectification under section 154.

Question 12

Examine critically in the context of provisions of the Act "Can the Assessing Officer issue notice under section 148 to reopen the same assessment order on the same grounds for which the CIT had issued notice under section 263 of the Act"?

Answer

The Assessing Officer cannot issue notice under section 148 to reopen the same assessment order on the same grounds for which the Commissioner had issued notice under section 263 of the Income-tax Act, 1961, since the third proviso to section 147 specifically provides that 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. Therefore, if the income relates to a matter which is the subject matter of revision under section 263, then the Assessing Officer cannot issue notice under section 148 to reopen the assessment order.

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Question 13

Is the Assessing Officer empowered to assess or reassess an income which is chargeable to tax and has escaped assessment, in a case which is pending before the Appellate Tribunal? Discuss.

Answer

As per third proviso to section 147, the Assessing Officer may assess or reassess an income which is chargeable to tax and which has escaped assessment, other than the income involving matters which are the subject matter of any appeal, reference or revision. Therefore, in respect of the matters which are the subject matter of an appeal before the Appellate Tribunal, it is not possible for the Assessing Officer to initiate proceeding under section 147. However, in respect of other matters, which are not the subject matter of the appeal, the Assessing Officer can initiate proceeding under section 147.

Question 14

A search was conducted under section 132 in the business premises of Harish on 15th December, 2017. At that time, assessments under section 143(3) for A.Y. 2015-16 and A.Y. 2016-17 and reassessment proceeding under section 147 for A.Y. 2014-15 were pending before the Assessing Officer.

(i) What are the assessment years for which notice can be issued for making post-search assessment?

(ii) What would be the fate of pending assessments and reassessment?

(iii) What would be the effect, if the post-search assessment orders are annulled by the Income-tax Appellate Tribunal?

Answer

(i) The notice under section 153A can be issued for six assessment years preceding the assessment year relevant to the previous year in which the search is conducted. In this case, the search is conducted in the previous year 2017-18, the relevant assessment year for which is A.Y.2018-19. Therefore, notice can be issued for the six preceding assessment years i.e. for assessment years 2012-13 to 2017-18.

Further, notice for assessment or reassessment can be issued by Assessing Officer for the relevant assessment year or years (i.e. for A.Y.2008-09 to A.Y.2011-12) if the following conditions are satisfied:

(a) The Assessing Officer has in his possession, books of account or other documents or evidence which reveal that the income, represented in the form of asset, which has escaped assessment amounts to or is likely to amount Rs.50 lakhs or more in the relevant assessment year or in aggregate in the relevant assessment years.

(b) The income so referred above has escaped assessment for such year or years; and

(c) The search under section 132 is initiated or requisition under section 132A is made on or after 01.04.2017 (This condition is satisfied since the search has taken place in December, 2017).

Note - The expression "relevant assessment year" shall mean an assessment year preceding the

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assessment year relevant to the previous year in which search is conducted or requisition is made which falls beyond six assessment years but not later than ten assessment years from the end of the assessment year relevant to the previous year in which search is conducted or requisition is made.

"Asset" shall include immovable property being land or building or both, shares and securities, loans and advances, deposits in bank account.

(ii) As per section 153A, the assessment or reassessment relating to any assessment year, falling within the above period of six assessment years and for the relevant assessment year or years, pending on the date of initiation of the search under section 132, shall abate. In other words, they will cease to be applicable. Therefore, the assessments under section 143(3) for assessment years 2015-16 and 2016-17 and the reassessment proceeding under section 147 for assessment year 2014-15 **shall abate.**

(iii) Section 153A provides that where the post-search assessment order is annulled in any appeal or any other legal proceeding, the abated assessment and reassessment proceedings shall stand revived. Therefore, the assessments under section 143(3) relating to assessment years 2015-16 and 2016-17 and the reassessment proceeding relating to assessment year 2014-15, which abated on initiation of search, **shall stand revived** with effect from the date of receipt of the order of such annulment by the Principal Commissioner or Commissioner.

Question 15

A search was conducted under section 132 in the business premises of Sanskar on 30th March, 2017. The search was concluded by executing last of authorisation for search on 4th April, 2017. Since the search is concluded in the financial year 2017-18, and other conditions are also fulfilled, the Assessing Officer issued notice under section 153A on Sanskar for preceding ten Assessment Years prior to the Assessment Year relevant to the previous year 2017-18. Thus, he issued the notice from A.Y. 2008-09 to A.Y.2017-18. Discuss the correctness of the action taken by Assessing Officer.

Answer

As per section 153A, the Assessing Officer can issue the notice to file a return in respect of six assessment years and for the relevant assessment year or 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.

However, no notice for assessment or reassessment shall be issued by Assessing Officer for the relevant assessment year or years unless :

(a) He has, in his possession, books of account or other documents or evidence which reveal that the income, represented in the form of assets, which has escaped assessment amounts to or is likely to amount Rs.50 lakhs or more in the relevant assessment year or in aggregate in the relevant assessment years.

(b) The income so referred above has escaped assessment for such year or years.

(c) The search under section 132 is initiated or requisition under section 132A is made on or after 01.04.2017

The expression "relevant assessment year" shall mean an assessment year preceding the assessment

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year relevant to the previous year in which search is conducted or requisition is made which falls beyond six assessment years but not later than ten assessment years from the end of the assessment year relevant to the previous year in which search is conducted or requisition is made.

Thus, it is clear that the Assessing Officer can issue the notice in respect of four assessment years which falls beyond six assessment years, subject to fulfillment of aforesaid conditions. As per condition (c) above, search must be initiated on or after 01.04.2017.

However, in the given case, Assessing Officer has initiated the search on 30.03.2017 and concluded on 04.04.2017. Therefore, the condition given in (c) is not satisfied. Thus, Assessing Officer could issue the notice only for six assessment years from the end of the assessment year relevant to the previous year in which search is conducted. i.e. from A.Y.2012-13 to A.Y. 2017-18.

Hence, the action of Assessing Officer in issuing the notice under section 153A for A.Y.2008-09 to A.Y.2011-12 is incorrect.

Question 16

Examine whether the Assessing Officer has the power to make any adjustment to income disclosed by the assessee in the return of income in course of processing the return under section 143(1)?

Answer

The procedure to be followed for summary assessment is contained in section 143(1). As per section 143(1), the total income or loss of an assessee shall be computed after making the following adjustments to the returned income:

(i) any arithmetical error in the return; or

(ii) an incorrect claim, if such incorrect claim is apparent from any information in the return.

(iii) disallowance of loss claimed, if return is filed beyond due date u/s 139(1)

(iv) disallowance of expenditure indicated in the audit report but not taken into account in computing the total income in the return

(v) disallowance of deduction claimed under section u/s 10AA, 80-IA, 80-IAB, 80-IB, 80-IC, 80-ID or 80-IE, if return is filed beyond due date u/s 139(1)

(vi) addition of income appearing in Form 26AS or Form 16A/16 which has not been included in computing the total income in the return

No such adjustment shall be made unless as intimation is given to the assessee of such adjustment either in writing or electronic mode. Further, Assessing Officer shall make any adjustment after considering the response received from the assessee, if any. Where no response is received with 30 days of the issue of such notice, the above adjustment can be made.

For the purpose of section 143(1), "an incorrect claim apparent from any information in the return" means such claim on the basis of an entry, in the return of income:

(i) of an item, which is inconsistent with another entry of the same or some other item in such return;

(ii) in respect of which, the information required to be furnished under the Income-tax Act, 1961 to substantiate such entry, has not been so furnished;

(iii) in respect of a deduction, where such deduction exceeds specified statutory limit which may be expressed as monetary amount or percentage or ratio or fraction.

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Question 17

Can the Assessing Officer complete the assessment of income from international transactions in disregard of the order passed by the Transfer Pricing Officer by accepting the contention of the assessee?

Answer

Section 92CA(4) provides that the order of the Transfer Pricing Officer determining the arm's length price of an international transaction is 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.

Therefore, the Assessing Officer cannot complete the assessment of income from international transactions in disregard of the order of Transfer Pricing Officer and on the basis of contention raised by the assessee.

Question 18

Tai Ltd. filed its return of income for assessment year 2017-18 on 6th June, 2017. The return is selected for regular assessment under section 143(3) for which notice under section 143(2) is served on the company on 3rd October, 2018. The company responded to the notice under section 143(2). Examine whether the service of the notice is within time and if not, whether the assessment order can be challenged by the assessee.

Answer

The time limit for service of notice under section 143(2) is six months from the end of the financial year in which the return of income was furnished by the assessee. The return of income for assessment year 2017-18 was filed by the assessee on 6th June, 2017. Therefore, the notice under section 143(2) has to be served by 30th September, 2018. However, the notice was served on the assessee only on 3rd October, 2018. Hence, the notice issued under section 143(2) is time-barred.

However, as per section 292BB, where an assessee had appeared in any proceedings or co- operated in any enquiry relating to an assessment or reassessment, it shall be deemed that any notice required to be served upon him, has been duly served upon him in time in accordance with the provisions of the Act and such assessee shall be precluded from raising any objection in any proceeding or enquiry that the notice was (a) not served upon him or (b) not served upon him in time or (c) served upon him in an improper manner.

The above provision shall not be applicable where the assessee has raised such objection before the completion of such assessment or reassessment. Therefore, in the instant case, if the assessee, Tai Limited, had raised an objection to the proceeding, on the ground of non-service of the notice under section 143(2) upon it on time, then, the validity of the assessment order can be challenged. In absence of such objection, the assessment order cannot be challenged.

Question 19

In the case of Mr. Rajesh, a summary assessment was made under section 143(1) for assessment year 2014-15 without calling him. Thereafter, Mr. Rajesh has received a notice under section 148 on 6th April, 2017 for reopening of assessment. Can Mr. Rajesh challenge the legality of the notice on the ground of change of opinion?

Answer

Under the scheme of section 143(1), only the adjustments relating to any arithmetical error in the return, incorrect claim which is apparent from any information in the return, disallowance of losses

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claimed where the relevant return of income was filed beyond the due date under section 139(1), disallowance of expenditure indicated in the audit report but not taken into account in computing total income in the return, disallowance of deduction claimed under section 10AA, sections 80-IA to 80-IE, where return is furnished beyond due date and addition of income appearing in Form 26AS or Form 16 or Form 16A which has not been included in computing the total income in the return are permitted. In short, what is permissible is only correction of errors apparent on the basis of the of the return and tax audit report filed as well as Form 26AS, Form 16 or Form 16A. Therefore, the intimation given under section 143(1) is only a preliminary assessment, commonly referred to as a summary assessment without calling the assessee. The same cannot be treated as an order of assessment under section 143(3). Since there has been no assessment under section 143(3) in this case, the question of change of opinion does not arise.

Therefore, the assessee cannot challenge the legality of the notice issued under section 148 reopening the assessment on the ground of change of opinion in a case where no assessment is made under section 143(3). This inference is supported by the Supreme Court ruling in ACIT vs. Rajesh Jhaveri Stock Brokers P. Ltd. (2007) 291 ITR 500.

Question 20

Discuss the correctness or otherwise of the following proposition in the context of the Income-tax Act, 1961:

A fresh claim before the Assessing Officer can be made only by filing a revised return and not otherwise.

Answer

This proposition is correct. A return of income filed within the due date under section 139(1) or a belated return filed under section 139(4) may be revised by filing a revised return under section 139(5) where the assessee finds any omission or wrong statement in the original return subject to satisfying other conditions. There is no provision in the Income-tax Act, 1961, to make changes or modification in the return of income by filing a letter. The revised return can be filed at any time before the end of the relevant assessment year or before completion of assessment, whichever is earlier. In a case where a return of income has been filed within the due date under section 139(1) or after the due date under section 139(4), the only option available to the assessee to make an amendment to such return is by way of filing a revised return under section 139(5). Therefore, a fresh claim can be made before the Assessing Officer only by filing a revised return and not otherwise. The Supreme Court in Goetze (India) Ltd. vs. CIT (2006) 284 ITR 323 has held that there is no provision in the Income-tax Act, 1961 to allow an amendment in the return of income filed except by way of filing a revised return.

Question 21

The Assessing Officer within the powers vested in him under section 142(2A), while examining the accounts of PNF Ltd., had ordered to get the same audited. The company challenges this order on the ground "that the opportunity was not provided to them by the Assessing Officer prior to passing of such an order". Decide the correctness of the action of the Assessing Officer.

Answer

As per the proviso to section 142(2A), the Assessing Officer shall not direct the assessee to get the accounts so audited unless the assessee has been given a reasonable opportunity of being heard.

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Therefore, in this case, the order of the Assessing Officer is not valid, since the assessee was not given an opportunity of being heard prior to passing of such order.

Question 22

Smt. Kanti engaged in the business of growing, curing, roasting and grounding of coffee after mixing chicory had a total income of Rs.6,00,000 from this business which was her only source of income during the year ended on 31.3.2018. She consults you to have an opinion whether she is required to file return of income for the A.Y. 2018-19 as per provisions of section 139(1).

Answer

The clarification regarding filing of return of income by the coffee growers being individuals covered by Rule 7B of the Income-tax Rules, 1962 is given in Circular No.10/2006 dated 16.10.2006. According to the Circular, an individual deriving income from growing, curing, roasting and grounding of coffee with or without mixing chicory, would not be required to file the return of income if the aggregate of 40% of his or her income from growing, curing, roasting and grounding of coffee with or without mixing chicory and income from all other sources liable to tax in accordance with the provisions of this Act, is equal to or less than the basic exemption limit prescribed in the First Schedule of the Finance Act of the relevant year.

In this case, Smt. Kanti has a total income of Rs.6,00,000 from this business, which was her only source of income for P.Y.2017-18. 40% of her total income works out to Rs.2,40,000, which is less than the basic exemption limit of Rs.2,50,000 in respect of an individual assessee. Therefore, Smt. Kanti is not required
to file a return of income for the A.Y.2018-19 as per the provisions of section 139(1).

Question 23

Ram, an individual, filed his return of income for the assessment year 2018-19 on 15.6.2018. He later discovered that he had not claimed deduction under section 80C in the said return. He claimed the said deduction through a letter addressed to the Assessing Officer. The Assessing Officer completed the assessment without allowing the deduction claimed by Ram. Is the Assessing Officer justified in doing so?

Answer

The Supreme Court has, in Goetze (India) Ltd. v. CIT (2006) 284 ITR 323, ruled that the assessing authority has no power to entertain a claim for deduction made after filing of the return of income otherwise than by way of a revised return. In the instant case, Ram has claimed the deduction under section 80C, which he omitted to claim in the original return of income, through a letter addressed to the Assessing Officer and not by filing a revised return under section 139(5). In view of the decision of the Supreme Court cited above, the Assessing Officer was justified in completing the assessment without allowing the deduction under section 80C.

Question 24

Examine the correctness or otherwise of the following statements in the context of provisions contained in the Income-tax Act, 1961 and the decided case laws:

"The Assessing Officer is bound to allow the set-off of brought forward losses under section 72 even if the assessee has not claimed the same in the return filed".

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Answer

The statement is correct.

The Supreme Court has, in CIT v. Mahalakshmi Sugar Mills Co. Ltd. (1986) 160 ITR 920, held that it is the duty of the Assessing Officer to apply the relevant provisions of the Act for the purpose of determining the true figure of the assessee's total income and consequential tax liability. Merely because the assessee has not claimed the set-off in the return filed, it cannot relieve the Assessing Officer of his duty to apply section 72 in the appropriate case.

As per CBDT Circular No.14 (XL-35) of 1955 dated 11.04.1955, it is the duty of the Assessing Officer to assist a taxpayer in every reasonable way, particularly in the matter of claiming and securing reliefs and in this regard, they should take the initiative in guiding a taxpayer where proceedings or other particulars before them indicate that some refund or relief is due to him.

Therefore, on the basis of the above Supreme Court ruling and the CBDT Circular, the Assessing Officer is bound to allow the set-off of brought forward losses under section 72, even if the assessee has not claimed the same in the return filed, provided the loss was determined in pursuance of a return filed under section 139(3) in any earlier previous year.

Moreover, the wording used in section 72 is "shall", indicating that the provisions relating to set off of brought forward business loss are mandatory.

Therefore, the Assessing Officer is bound to allow the claim for set off of brought forward business losses even if the assessee has not claimed the same in the return filed.

Question 25

X, an individual, has got his books of account for the year ending 31.3.2018 audited under section 44AB. His total income for the assessment year 2018-19 is Rs.2,60,000. He desires to know if he can furnish his return of income for the assessment year 2018-19 through a Tax Return Preparer.

Answer

Section 139B provides for submission of return of income through Tax Return Preparers. It empowers the Central Board of Direct Taxes (CBDT) to frame a scheme for the purpose of enabling any specified class or classes of persons to prepare and furnish their returns of income through Tax Return Preparers. Specified class or classes of persons have been defined to mean any person, other than a company or a person whose accounts are required to be audited under section 44AB or under any other existing law, who is required to furnish a return of income under the Act. Thus, companies and persons whose accounts are liable for tax audit under section 44AB do not fall within the definition of 'specified class or classes of persons' and consequently, cannot furnish their returns of income through Tax Return Preparers. In the instant case, the books of account of X for the year ending 31.3.2018 have been audited under section 44AB. As such, he cannot furnish his return of income for the assessment year 2018-19 through a Tax Return Preparer.

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SIGNIFICANT SELECT CASES

1. **Can unabsorbed depreciation be allowed to be carried forward in case the return of income is not filed within the due date?**

   CIT v. Govind Nagar Sugar Ltd. (2011) 334 ITR 13 (Delhi)

   High Court's Observations: On this issue, the Delhi High Court observed that, the provisions of section 80 and section 139(3), requiring the return of income claiming loss to be filed within the due date, applies to, inter alia, carry forward of business loss and not for the carrying forward of unabsorbed depreciation. As per the provisions of section 32(2), the unabsorbed depreciation becomes part of next year's depreciation allowance and is allowed to be set-off as per the provisions of the Income-tax Act, 1961, irrespective of whether the return of earlier year was filed within due date or not.

   High Court's Decision: Therefore, in the present case, the High Court held that the unabsorbed depreciation will be allowed to be carried forward to subsequent year even though the return of income of the current assessment year was not filed within the due date.

2. **Can an assessee revise the particulars filed in the original return of income by filing a revised statement of income?**

   Orissa Rural Housing Development Corpn. Ltd. v. ACIT (2012) 343 ITR 316 (Orissa)

   High Court's Decision: On this issue, the Orissa High Court held that the assessee can make a fresh claim before the Assessing Officer or make a change in the originally filed return of income only by filing revised return of income under section 139(5). There is no provision under the Income-tax Act, 1961 to enable an assessee to revise his income by filling a revised statement of income. Therefore, filling of revised statement of income is of no value and will not be considered by the Assessing Officer for assessment purposes.

   The High Court, relying on the judgement of the Supreme Court in *Goetze (India) Ltd. v. CIT (2006) ITR 323,* held that the Assessing Officer has no power to entertain a fresh claim made by the assessee after filing of the original return except by way of filing a revised return.

3. **Is a person having income below taxable limit, required to furnish his PAN to the deductor as per the provisions of section 206AA, even though he is not required to hold a PAN as per the provisions of section 139A?**

   Smt. A. Kowsalya Bai v. UOI (2012) 346 ITR 156 (Kar.)

   As per the provisions of section 139A, inter alia, a person whose total income does not exceed the maximum amount not chargeable to income-tax is not required to apply to the Assessing Officer for the allotment of a permanent account number (PAN).

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However, as per the provisions of section 206AA, notwithstanding anything contained in any other provision of this Act, any person who is entitled to receive any sum or income or amount on which tax is deductible under Chapter XVII-B, i.e., the deductee, shall furnish his PAN to the deductor, otherwise tax shall be deducted as per the provisions section 206AA, which is normally higher. It is mandatory for an assessee to furnish his PAN, despite filing Form 15G as required under section 197A, to seek exemption from deduction of tax.

The provisions of section 139A are contradictory to section 197A, due to the fact that assessees whose income was less than the maximum amount not chargeable to income-tax, were not required to hold PAN, whereas their declaration furnished under section 197A was not accepted by the bank or financial institution unless PAN was communicated as per the provisions of section 206AA. The provisions of section 206AA creates inconvenience to small investors, who invest their savings from earnings as security for their future, since, in the absence of PAN, tax was deducted at source at a higher rate.

High Court's Decision: In order to avoid undue hardship caused to such persons, the Karnataka High Court, in the present case, held that it may not be necessary for such persons whose income is below the maximum amount not chargeable to income-tax to obtain PAN and in view of the specific provision of section 139A, section 206AA is not applicable to such persons. Therefore, the banking and financial institutions shall not insist upon such persons to furnish PAN while filing declaration under section 197A. However, section 206AA would continue to be applicable to persons whose income is above the maximum amount not chargeable to income-tax.

4. Can the Assessing Officer reopen an assessment on the basis of merely a change of opinion?

Aventis Pharma Ltd. v. ACIT (2010) 323 ITR 570 (Bom.)

The power to reopen an assessment is conditional on the formation of a reason to believe that income chargeable to tax has escaped assessment. The existence of tangible material is essential to safeguard against an arbitrary exercise of this power.

High Court's Observations and Decision: In this case, the High Court observed that there was no tangible material before the Assessing Officer to hold that income had escaped assessment within the meaning of section 147 and the reasons recorded for reopening the assessment constituted a mere change of opinion. Therefore, the reassessment was not valid.

5. Is it permissible under section 147 to reopen the assessment of the assessee on the ground that income has escaped assessment, after a change of opinion as to a loss being a speculative loss and not a normal business loss, consequent to a mere re-look of accounts which were earlier furnished by the assessee during assessment under section 143(3)?

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ACIT v. ICICI Securities Primary Dealership Ltd. (2012) 348 ITR 299 (SC)

Facts of the case: In the above case, the Assessing Officer had completed the assessment of assessee under section 143(3) after taking into consideration the accounts furnished by assessee. After the lapse of four years from relevant assessment year, the Assessing Officer had reopened the assessment of assessee under section 147 on the ground that after re-look of the accounts of the relevant previous year, it was noticed that the assessee company had incurred a loss in trading in share, which was a speculative one. Therefore, such loss can only be set off against speculative income. Consequently, the loss represents income which has escaped assessment. Accordingly, the Assessing Officer came to a conclusion that income had escaped assessment and passed an order under section 147.

Supreme Court's Decision: The Supreme Court observed that the assessee had disclosed full details in the return of income in the matter of its dealing in stocks and shares. There was no failure on the part of assessee to disclose material facts as mentioned in proviso to section 147. Further, there is nothing new which has come to the notice of the Assessing Officer. The accounts had been furnished by the assessee when called upon. Therefore, re-opening of the assessment by the Assessing Officer is clearly a change of opinion and therefore, the order of re-opening the assessment is not valid.

6. Can a notice under section 148 for a particular assessment year be issued solely on the ground that survey under section 133A was carried on at the business premises of the assessee, where nothing had been found therein which would indicate escapement of income chargeable to tax for the said assessment year?

Hemant Traders v. ITO (2015) 375 ITR 167 (Bom)

Facts of the case: In the present case, the assessee is a partnership firm and registered as a Commission agent of the onion potato market under the Agricultural Produce Market, Committee, Navi Mumbai. The firm is regularly assessed to income-tax. The firm filed a return of income for A.Y.2010-11 on October 14, 2010 along with audit report, audited Balance Sheet and Profit & Loss Account for the year ended 31.3.2010. The return was processed and intimation under section 143(1) was issued on 20.02.2012, seeking clarification. No assessment order was passed. The assessee claimed that the profit as per the return of income was accepted. Meanwhile, a survey under section 133A was carried out at the business premises of the assessee on 7th January 2011 pertaining to A.Y.2011-12. However, the survey party did not find any discrepancy in the books of account. Further, the survey report did not contain any reference to any transactions for A.Y.2010-11. In March 2014, the assessee was issued a notice under section 148 for the A.Y.2010-11 based on the said survey.

The assessee preferred a writ challenging the issue of notice on the reasoning that no satisfaction was recorded of the escapement of income in the survey report or in any other relevant material. Ex-facie, the reassessment was bad in law.

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High Court's Observations: The High Court perused the survey report which recorded that there was a group of assessees who were engaged in wholesale trading of potato on commission basis. The survey was conducted based on the allegations that these parties were resorting to hoarding of potatoes and making huge profits by fluctuating the day-to-day price of potatoes in the market. During survey, the assessee's books of account, cash balance and stocks were physically verified and inventory prepared. The report revealed cash difference of Rs.5,020 and the explanation given was that the same pertained to the day-to-day and miscellaneous expenditure incurred on the day of survey. The report also revealed physical stock difference of 672 bags of potatoes. The explanation for such difference was recorded.

Neither the survey report nor any other material indicated escapement of income chargeable to tax for A.Y.2010-11. The Assessing Officer had nothing before him to record his belief or satisfaction that escapement of income had taken place.

Merely because survey had taken place cannot be a ground for reopening the assessment without valid material or evidence at the time of issue of notice. Whenever there was shortage of potatoes in the market, such powers of survey were invoked. Where nothing has been found during the survey operations to indicate that income chargeable to tax has escaped assessment, then the survey report ought not to be the basis for reopening of assessment. Something more was required in law for the Assessing Officer to exercise his powers.

High Court Decision: The High Court, accordingly, held that since there is absolutely no material to indicate escapement of income for the relevant assessment year, the issue of notice to initiate reassessment proceedings under section 148 on the basis of survey which had taken place is not valid. Therefore, the proceedings initiated under section 148 are quashed at the threshold itself.

7. Will the subsequent amendment of law with retrospective effect validate a reassessment notice issued on a different ground before the retrospective amendment was made?

Godrej Industries Ltd v. B.S. Singh Dy.CIT (2015) 377 ITR 1 (Bom)

Facts of the case: The assessee-company filed its return of income for the assessment year 2000-01 declaring total income as 'Nil' and a book profit of Rs. 52.70 crores. This resulted in 'book profit' being assessed to income-tax. Later, the Assessing Officer issued notice under section 148 for the reason that income chargeable to tax had escaped assessment on the ground that the provision for doubtful debts and provision for depletion of long-term investment debited to the profit and loss account were unascertained liabilities and, hence, in terms of clause (c) of the Explanation to section 115JA, i.e., they were to be added back to the net profit for arriving at the book profits.

The assessee preferred a writ challenging the maintainability of the notice issued under section 148.

Revenue's Contention: The Revenue contended that at the time of issuing the impugned notice on March 29, 2007, the position was not clear. The position became clear only when Parliament introduced/added clause (g) to the Explanation to section 115JA of the Act with retrospective

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effect from April 1, 1998, and which reads as under:

"(g) the amount or amounts set aside as provision for diminution in the value of any asset."

Thus, the Revenue submitted that the impugned notice is sustainable on the basis of above clause (g) of the Explanation to section 115JA, inserted by the Finance (No.2) Act, 2009 retrospectively with effect from 1st April, 1998.

High Court's Observations: The High Court observed that an identical issue had come up in Rallis India Ltd. v. Asst. CIT [2010] 323 ITR 54 (Bom) wherein a reopening notice was, inter alia, issued on the ground that the book profits have to be increased by the provision made for doubtful debts and for diminution in the value of investment in view of clause (c) of the Explanation to section 115JB. In the said case, the High Court recorded the fact that the Apex Court had, in CIT v. HCL Comnet Systems and Services Ltd. [2008] 305 ITR 409, held that the provision for doubtful debts is a provision made for diminution in the value of assets and is not a liability. Thus, it would not fall under clause (c) of the Explanation to section 115JA of the Act. Consequent to the aforesaid decision of the Apex Court, the Parliament has amended the Explanation both under section 115JA as well as section 115JB of the Act in 2009 by adding clause (g) and clause (i) with retrospective effect from April 1, 1998, and April 1, 2001, respectively. The Court held that though the amendment was made with the retrospective effect, the critical date is the date on which the Assessing Officer exercises jurisdiction under section 148 of the Act and the subsequent amendment could not have been and is in fact not a ground on which the Assessing Officer sought to reopen the assessment. It was held that the validity of a reopening notice of Assessing Officer is to be determined with reference to the reasons which are recorded in support of thereof and nothing else.

In this case also, it is clear that the reasons stated for reopening the assessment are that provision for doubtful debts and depletion in value of investments are both amounts set aside for meeting liabilities other than ascertained liabilities and hence, constitute income escaping assessment. The reasons recorded are not valid as the said items were not related to liabilities as perceived by the Assessing Officer. These provisions are made to take care of the likely fall in the value of assets.

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The High Court observed that it is the Assessing Officer's belief at the time of issuing the reassessment notice that determines the validity of the notice. In this case, he wanted to apply clause (c) of the Explanation to section 115JA and whereas the issues got covered by subsequent amendment by means of insertion of clause (g) to the Explanation to section115JA by the Finance (No.2) Act, 2009 with retrospective effect from 1.4.1998. The subsequent event could not put life into the Assessing Officer's reason that income chargeable to tax had escaped assessment when the reasons as originally recorded are still born.

High Court's Decision: The position of law on the date of issue of notice under section 148 must be looked into and the retrospective amendment subsequent to issue of notice could not validate a notice issued earlier. It could only amount to change of opinion and the notice for reopening of assessment would become unsustainable.

The High Court, accordingly, allowed the writ and held that the reason for reopening the assessment cannot get validated by the retrospective amendment of law.

Note – It may be noted that section 115JA levying MAT was applicable from A.Y.1997-98 to A.Y.2000-01. From A.Y.2001-02, MAT is attracted under section 115JB. Clause (c) of Explanation 1 to section 115JB requires addition of amount set aside to provisions made for meeting liabilities, other than ascertained liabilities, to the net profit for arriving at the book profit for levy of MAT. Clause (i) was inserted by the Finance (No.2) Act, 2009 retrospectively with effect from 1st April, 2001 providing for addition of amount set aside as provision for diminution in the value of any asset, to the net profit for arriving at the book profit for levy of MAT. The rationale of the above ruling would, therefore, also apply in the context of examining the validity of notice issued for reopening an assessment on the basis of clause (c) of Explanation 1 to section 115JB, consequent to subsequent retrospective insertion of clause (i) in Explanation 1 to section 115JB.

8. Can the Assessing Officer reassess issues other than the issues in respect of which proceedings were initiated under section 147 when the original "reason to believe" on the basis of which the notice was issued ceased to exist?

I **Delhi High Court ruling in Ranbaxy Laboratories Ltd. v. CIT (2011) 336 ITR 136:**

Facts of the case: In the present case, the assessee company was engaged in the business of manufacture and trading of pharmaceutical products. The Assessing Officer accepted the returned income filed by the assessee but initiated reassessment proceedings under section 147 in respect of the addition to be made on account of club fees, gifts and presents and provision for leave encashment. It was observed that the Assessing Officer had reason to believe that income has escaped assessment due to claim and allowance of such expenses and accordingly, he issued notice under section 148. However, after sufficient enquiries were made during reassessment proceedings, the Assessing Officer came to the conclusion that no additions are required to be made on account of these expenses. Therefore, while completing the reassessment he did not make additions on account of these items but instead made additions on the basis of other issues which were not the original "reason to believe" for the issue of notice under section 148. The Assessing Officer made such additions on the basis of Explanation 3 to

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section 147 as per which the Assessing Officer may assess the income which has escaped assessment and which comes to his notice subsequently in the course of proceedings under section 147 even though the said issue did not find mention in the reasons recorded in the notice issued under section 148.

Issue: The issue under consideration is whether the Assessing Officer can make an assessment on the basis of an issue which came to his notice during the course of assessment, where the issues, which originally formed the basis of issue of notice under section 148, were dropped in its entirety.

High Court's Observations: As per section 147, the Assessing Officer may assess or reassess such income **and also** any other income chargeable to tax which has escaped assessment and which comes to his notice in the course of proceedings under this section. The Delhi High Court observed that the words "and also" used in section 147 are of wide amplitude.

The correct interpretation of the Parliament would be to regard the words **'and also'** as being "conjunctive and cumulative with" and not "in alternative to" the first part of the sentence, namely, "the Assessing Officer may assess and reassess such income". It is significant to note that Parliament has not used the word 'or' but has used the word 'and' together and in conjuction with the word 'also'. The words 'such income' in the first part of the sentence refer to the income chargeable to tax which has escaped assessment and in respect of which the Assessing Officer has formed a reason to believe for issue of the notice under section 148. Hence, the language used by the Parliament is indicative of the position that the assessment or reassessment must be in respect of the income, in respect of which the Assessing Officer has formed a reason to believe that the same has escaped assessment and also in respect of any other income which comes to his notice subsequently during the course of the proceedings as having escaped assessment.

High Court's Decision: If the income, the escapement of which was the basis of the formation of the "reason to believe" is not assessed or reassessed, it would not be open to the Assessing Officer to independently assess only that income which comes to his notice subsequently in the course of the proceedings under the section as having escaped assessment. If he intends to do so, a fresh notice under section 148 would be necessary.

II **Punjab & Haryana High Court ruling in CIT v. Mehak Finvest P Ltd (2014) 367 ITR 769:**

Facts of the case: In the present case, reassessment proceedings were initiated against the assessee on the reason that various finance companies managed and controlled by certain persons were engaged in accommodation entries and the assessee-company was one among them. However, during the reassessment proceedings, the Assessing Officer noticed that fresh share application money amounting to Rs.47 lakhs could not be explained by the assessee and hence invoked section 68 to bring to tax such sum. There was no addition on the basis of the original reason for which reassessment proceedings were initiated.

Issue: The issue under consideration is whether an addition can be made in reassessment when the original reasons on the basis of which notice for reassessment was issued did not survive.

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Assessee's Contention vis-a-vis Revenue's Contention: The assessee contended that when the original reason prompting the initiation of reassessment proceedings did not survive, the question of making addition on some other fresh grounds was not possible. The basis of the assessee's contention was the Bombay High Court ruling in case of CIT v. Jet Airways (I) Ltd (2011) 331 ITR 236 and Delhi High Court ruling in Ranbaxy Laboratories Ltd v. CIT (2011) 336 ITR 136.

On the other hand, the Revenue placed reliance on the jurisdictional High Court decision in the case of Majinder Singh Kang v. CIT (2012) 344 ITR 358 holding that reassessment can be made on the basis of additional grounds, even though the original reason forming the basis of issue of notice did not survive.

High Court's Observations: The High Court noted that Explanation 3 to section 147 nowhere postulates or contemplates that the Assessing Officer cannot make any additions on any other ground unless some addition is made on the basis of the original ground for which reassessment proceeding was initiated. It cited the dismissal of special leave petition (SLP) against the High Court ruling in Majinder Singh Kang's case by the Supreme Court on 19.08.2011 as the binding precedent.

High Court's Decision: The High Court, accordingly, held that even though no addition is made on the original grounds which formed the basis of initiation of reassessment proceedings, the Assessing Officer is empowered to make additions on another ground for which reassessment notice might not have been issued but which came to his notice subsequently during the course of proceedings for reassessment.

III **Karnataka High Court ruling in N. Govindaraju v. ITO (2015) 377 ITR 243**

Facts of the case: The assessee, an individual, deriving income from house property, transport business, capital gains and other sources filed his return of income declaring total income of Rs.4.82 lakhs and agricultural income of Rs.1.62 lakhs. The return was processed under section 143(1). Subsequently, a notice under section 148 was issued stating that the assessee had converted agricultural land into non-agricultural purposes, formed sites and sold the same but while arriving at the indexation benefit it was taken up to the date of sale instead of the date of conversion as per section 45(2). Thus, the reason for reassessment was the excessive indexation benefit availed by the assessee. However, in reassessment, the Assessing Officer adopted fair market value which was less than what was adopted by the assessee and also sought to disallow 50% of the expenses incurred on transfer. The original reason which prompted the reassessment was dropped and based on fresh grounds, reassessment was completed.

Issue under consideration: One of the issues under consideration before the High Court was whether the reassessment based on fresh grounds would be valid when the original reason which prompted the reassessment, does not survive.

Assessee's contention vis-s-vis Revenue's contention: The assessee contended that the reason for which notice was issued has to survive and it is only thereafter that "any other income" which is found to have escaped assessment can also be assessed or reassessed in such

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proceeding. On the other hand, the Revenue claimed that section 147 is in two parts which have to be read independently; the phrase "such income" in the first part is with regard to reasons which have been recorded and the phrase "any other income" is with regard to cases where no reasons are recorded in the notice but they come to the notice of the Assessing Officer during the course of reassessment proceeding. Both being independent, once the satisfaction in the notice is found sufficient, addition can be made on all grounds i.e., for reasons which have been recorded and also for items for which no reasons were recorded. All that is necessary is that, during the course of the proceedings under section 147, income chargeable to tax must have escaped assessment.

High Court's Observations: The High Court observed that the controversy revolved around Explanation 3 to section 147 inserted by the Finance (No.2) Act 2009 retrospectively with effect from 1.4.1989. The Court took note of Circular No.5/2010 issued by CBDT after the amendment in Paragraph 47 with caption 'Clarificatory amendment in respect of reassessment proceeding under section 147". Para 47.3 reads as under:

"Therefore, to articulate the legislative intention clearly Explanation 3 has been inserted in section 147 to provide that the Assessing Officer may examine, assess or reassess any issue relevant to income which comes to his notice subsequently in the course of proceedings under this section, notwithstanding that the reason for such issue has not been included in the reasons recorded under section 148(2)".

The High Court observed that it is true that if the foundation goes, then, the structure cannot remain. Meaning thereby, if notice has no sufficient reason or is invalid, no proceedings can be initiated. However, this can be verified at the initial stage by challenging the notice. If the notice is challenged and found to be valid, or where the notice is not at all challenged, then, in either case, it cannot be said that notice is invalid. As such, if the notice is valid, then the foundation remains and the proceedings on the basis of such notice can continue. The High Court reiterated that once the proceedings have been initiated on a valid notice, it becomes the duty of the Assessing Officer to levy tax on the entire income (including "any other income") which may have escaped assessment and comes to his notice during the course of the proceedings initiated under section 147.

High Court's Decision: The High Court held that, in effect, once satisfaction of reasons for the notice is found sufficient i.e. if the notice under section 148(2) is found to be valid, then, the Assessing Officer may do reassessment in respect of any other item of income which may have escaped assessment, even though the original reason for issue of notice under section 148 does not survive.

This decision has dissented from the decisions in the case of *CIT v. Jet Airways (I) Ltd (2011) 331 ITR 236 (Bom); Ranbaxy Laboratories Ltd v. CIT (2011) 336 ITR 136 (Del).*

Note – In this case, the reassessment on the basis of reasons, which did not form the original reasons to believe, but were subsequently discovered by the Assessing Officer, was held to be valid, even though the original reasons did not survive.

However, the High Court further delved into the additional grounds, and held that the Tribunal was not justified in arriving at the fair market value of the property in question on 1.4.1981 without

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considering the material on record, including the valuation report, filed by the assessee. The matter was thus to be remanded to the Assessing Officer for determination of the fair market value of the property in question in accordance with law.

Further, without assigning any reason, the Assessing Officer had disallowed 50% of the total expenditure claimed by the assessee towards transfer and brokerage charges, even when the same had been paid by cheque and the receipt for which was obtained from the broker. When the specific case of the assessee was that heavy brokerage had to be paid because the property was under litigation and that it was occupied by unauthorised persons for which payment had to be made to get it vacated, disallowance could not be made on the ground that brokerage was generally being paid at the rate of 1-2%. The High Court opined that when the said brokerage was paid by cheque and there was sufficient reason for paying higher brokerage, the entire amount ought to have been allowed and disallowance of 50% was not justified in law.

Thus, in this case, though the High Court upheld that reassessment could be made on fresh grounds even when the original reasons recorded for reopening the assessment did not survive, additions made on the basis of such fresh grounds were turned down by the High Court, since the reasons were not justified to merit such additions.

9. Would the reassessment proceedings initiated under section 147 against the legal heirs of the deceased assessee be valid if notice of reassessment was sent to the legal heirs after the limitation period, though a notice addressed to the deceased assessee was sent prior to the limitation period?

Vipin Walia v. ITO (2016) 382 ITR 19 (Del)

Facts of the case: A notice under section 148 dated 27th March, 2015 was addressed to the assessee for the assessment year 2008-09. The notice got returned unserved with the postal authorities endorsing on it the remarks "addressee expired". Later, the Assessing Officer issued a letter dated 15.06.2015 to the petitioner seeking details of legal heirs/successors of the deceased (assessee) to complete the proceedings for the assessment year 2008-09.

The assessee, being one of the legal representatives of the deceased, wrote to the Assessing Officer pointing out that the proceedings initiated under section 148 were barred by limitation. The Assessing Officer proceeded to make the assessment under section 147 which the assessee challenged by means of a writ.

High Court's Observations: The High Court took note of section 159 which sets out the procedure to be adopted when the assessment is made on the legal representatives. Section 159(2)(a) states that any proceeding already taken against an assessee 'before his death' shall be deemed to have been taken against the legal representative. As per section 159(2)(b), any proceeding which could have been taken against the deceased if he had survived, may be taken against the legal representative of the deceased assessee, even if it had not been taken while the assessee was alive.

The Assessing Officer initiated proceedings under section 147 against the deceased for the assessment year 2008-09. The time limit for issue of notice was 31.03.2015, since the income escaping assessment exceeded Rs.1 lakh. On March 27, 2015 when the notice was issued, the

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assessee was already dead. If the Department intended to proceed under section 147, it could have done so prior to 31.03.2015 by issuing a notice to the legal representatives of the deceased. Beyond that date, it could not have proceeded in the matter even by issuing notice to the legal representatives of the assessee.

High Court's Decision: The High Court, accordingly, held that issue of notice on the legal representatives beyond the limitation time would render the reassessment proceedings invalid.

10. Does the finding or direction in an appellate order that income relates to a different assessment year empower reopening of assessment for that assessment year, irrespective of the expiry of the six year time limit?

CIT v. PP Engineering Work (2014) 369 ITR 433 (Del)

Facts of the case: The Tribunal, in its order, directed that the cash credit of Rs.32 lakhs found credited in the books of the assessee in the financial year 1999-2000 is chargeable to tax in the assessment year 2000-01 as against the assessment made by taxing the said amount in the assessment year 2001-02. In short, the Tribunal gave a finding that the cash credit under section 68 was assessable in a different assessment year than the assessment year in respect of which it heard the appeal. This prompted the Assessing Officer to issue a notice under section 148 in February, 2009 for reopening the proceedings for the A.Y. 2000-01. The issue is validity of notice issued after a lapse of 6 years from the end of the relevant assessment year.

The Commissioner (Appeals) held that the reassessment is barred by time limitation and the Tribunal also upheld the order of the Commissioner (Appeals) without making reference to section 150 read with Explanation 2 to section 153.

High Court's Opinion: The High Court made reference to section 150 which overrides the time limitation specified in section 149. Also, Explanation 2 to section 153 makes it clear that when an order in appeal, revision or reference is made whereby any income is excluded from the total income of an assessee for an assessment year, an assessment of such income for another assessment year shall be deemed to be one made in consequence of or to give effect to any finding or direction contained in the said order for the purposes of section 150 and section 153.

The High Court made reference to the Delhi High Court ruling in the case of Rural Electrification Corporation Ltd v. CIT (2013) 355 ITR 345 and opined that the findings of Commissioner (Appeals) and Tribunal on the question of limitation as legally untenable and incorrect.

High Court's Decision: The High Court observed that in view of the order of the Tribunal that the credit entries related to the earlier assessment year i.e., A.Y.2000-01, the Assessing Officer initiated reassessment proceedings under section 147 by issue of notice under section 148 for the year and passed an order dated 29/12/2009 making an addition of ` 32 lakhs. The High Court held that by virtue of section 150 read with *Explanation 2* to section 153, the said order was not barred by limitation.

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Note – *Under section 149(1)(b), the time limit for issue for notice under section 148 is six years from the end of the relevant assessment year, where the income chargeable to tax which has escaped assessment amounts to or is likely to amount to ` 1 lakh or more for that year.*

Section 150(1) states that notwithstanding anything contained in section 149, notice under section 148 may be issued at any time for the purpose of making an assessment or reassessment or recomputation in consequence of or to give effect to any finding or direction contained in an appellate or revisionary order.

Explanation 2 to section 153 provides that where by an order referred to in section 250, 254, 260, 262, 263 or 264, any income is excluded from the total income of the assessee for an assessment year, then, an assessment of such income for another assessment year shall, for the purposes of section 150 and section 153, be deemed to be one made in consequence of or to give effect to any finding or direction contained in the said order.

11. Is initiation of reassessment beyond a period of 4 years on the basis of subsequent Tribunal and High Court ruling valid, if there is no failure on the part of the assessee to disclose fully and truly all materials facts?

Allanasons Ltd v. Dy. CIT (2014) 369 ITR 648 (Bom)

Facts of the case: The assessee-company filed its return of income in which a claim for deduction under Chapter VI-A was made. The case was subjected to scrutiny assessment and order under section 143(3) was passed reducing the claim for deduction under Chapter VI-A. After 4 years from the end of the assessment year, a notice under section 148 was issued ascribing reasons such as subsequent tribunal and other court decisions which show that the deduction was excessively allowed in this case. The assessee challenged the reassessment proceedings by means of a writ before the court, contending that it is a settled position in law that the decision rendered by court subsequent to the assessment order does not by itself amount to failure on the part of the assessee to fully and truly disclose all material facts necessary for assessment.

High Court's Opinion: The High Court observed that it is well settled in terms of the proviso to section 147, that where any assessment is sought to be opened beyond a period of four years from the end of the relevant assessment year, two conditions have to be fulfilled cumulatively. The first condition is that there must be reason to believe that income chargeable to tax has escaped assessment. The second condition is that such escapement of income should have arisen due to failure on the assessee's part to fully and truly disclose all material facts required for the assessment.

Thus, escapement of income prompting reopening of assessment beyond the period of 4 years from the end of the assessment year is not possible unless it is due to the failure of the assessee to disclose fully and truly all material facts necessary for assessment.

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Even a subsequent change of law cannot be taken as income escaping assessment for triggering reassessment provisions beyond 4 years from the end of the assessment year unless there was a failure on the part of the assessee to disclose fully and truly all material facts necessary for assessment. The High Court observed that in this case, the reasons recorded, when read as a whole did not indicate even remotely any failure on the part of the assessee to disclose fully and truly any material fact necessary for assessment.

High Court's Decision: The High Court, accordingly, held that a subsequent decision of Tribunal or High Court by itself is not adequate for reopening the assessment completed earlier under section 143(3) unless there is a failure on the part of the assessee to disclose complete facts.

12. Is recording of satisfaction and quantification of escaped income a pre-condition for issuing notice under section 148 after 4 years from the end of the relevant assessment year?

Amarnath Agrawal v. CIT (2015) 371 ITR 183 (All)

Facts of the case: The assessee along with four others had obtained a lease of land and was in possession of the same from 1953. Subsequently, the State Government introduced a policy for conversion of lease-hold to free-hold. The assessee applied for conversion before the District Magistrate in 1997 and a sale deed was executed. The assessee deposited the necessary charges as demanded by the State Government and a freehold sale deed dated 25th March, 1998 was executed. The assessee sold a portion of the land during the F.Y. 1999-2000 and admitted the same as long-term capital gain taking into account the lease hold period also. In the assessment, the admission of income as long-term capital gain was accepted. However, after the expiry of four years from the end of the relevant assessment year, proceeding for reassessment of such income as short-term capital gains was resorted to by the Revenue on the ground that the lease hold period should not be considered for determining the period of holding of freehold land transferred. The assessee filed a writ challenging the validity of notice issued under section 148 stating that the requirements of section 149 read with section 151 were not considered by the Revenue.

High Court's Opinion and Decision: The High Court observed that two distinct conditions must be satisfied for assuming jurisdiction to issue a notice under section 148 after a period of 4 years viz. (i) escapement of income; and (ii) omission or failure on the part of the assessee to disclose fully and truly all material facts necessary for his assessment.

Under section 149(1)(b), it is imperative for the Assessing Officer, in his reasons, to state that the escaped income is likely to be Rs.1 lakh or more. This is an essential ingredient for seeking approval and the basis on which satisfaction is to be recorded by the competent authority under

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section 151. If the condition precedent to substantiate the satisfaction of escapement of income is not made, the issuance of notice would be invalid.

In this case, since no reasons were recorded that the escaped income is likely to be Rs.1 lakh or more so that the Chief Commissioner or Commissioner may record his satisfaction under section 151, the initiation of reassessment proceedings after four years was barred by time. The reasons recorded by the Assessing Officer were that the assessee had computed long- term capital gains tax liability, whereas he was liable to pay short-term capital gains tax, since he had sold a portion of the property within 3 years from the date of conversion of leasehold land into a freehold land.

The High Court observed that the property was held for more than 3 years and the conversion from leasehold to freehold being an improvement of the title did not have any effect on the taxability of profits. The reasons recorded by the Assessing Officer did not indicate any failure on the part of the assessee to disclose fully and truly all material facts at the time of assessment; it also did not indicate that the quantum of escapement of income exceeds Rs.1 lakh. Accordingly, the High Court held that, in this case, the issue of notice under section 148 after the four year time period was not valid.

13. In case of change of incumbent of an office, can the successor Assessing Officer initiate reassessment proceedings on the ground of change of opinion in relation to an issue, which the predecessor Assessing Officer who framed the original assessment had already applied his mind and come to a conclusion?

H. K. Buildcon Ltd. v. Income-tax Officer (2011) 339 ITR 535 (Guj.)

High Court's Observations: On this issue, the Gujarat High Court referred to the ruling of the Apex Court in CIT v. Kelvinator of India Ltd. (2010) 320 ITR 561, wherein it was held that the Assessing Officer has the power only to reassess and not to review. Reassessment has to be based on fulfillment of certain precondition and if the concept of change of opinion is removed, then, in the garb of reopening the assessment, review would take place. The Apex Court further laid down that one must treat the concept of change of opinion as an in-built test to check abuse of power by the Assessing Officer. The Apex Court referred to Circular No.549 dated 31.10.1989 explaining the amendment made by the Direct Tax Laws (Amendment) Act, 1989 with effect from 1.4.1989 to reintroduce the expression "reason to believe", and concluded that if the phrase "reason to believe" is omitted, the same would give arbitrary powers to the Assessing Officer to reopen the past assessment on mere change of opinion and this is not permissible even as per legislative intent.

High Court's Decision: The Gujarat High Court, applying the rationale of the Apex Court ruling, observed that in the entire reasons recorded in this case, there was nothing on record to show that income had escaped assessment in respect of which the successor Assessing

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Officer received information subsequently, from an external source. The reasons recorded themselves indicated that the successor Assessing Officer had merely recorded a different opinion in relation to an issue to which the Assessing Officer, who had framed the original assessment, had already applied his mind and come to a conclusion. The notice of reassessment was, therefore, not valid.

14. Would the doctrine of merger apply for calculating the period of limitation under section 154(7)?

CIT v. Tony Electronics Limited (2010) 320 ITR 378 (Del.)

Issue : The issue under consideration is whether the time limit of 4 years as per section 154(7) would apply from the date of original assessment order or the order of the Appellate Authority.

High Court's Decision: The High Court held that once an appeal against the order passed by an authority is preferred and is decided by the appellate authority, the order of the Assessing Officer merges with the order of the appellate authority. After merger, the order of the original authority ceases to exist and the order of the appellate authority prevails.

Thus, the period of limitation of 4 years for the purpose of section 154(7) has to be counted from the date of the order of the Appellate Authority.

***Note** - In this case, the Delhi High Court has followed the decision of the Supreme Court in case of Hind Wire Industries v. CIT (1995) 212 ITR 639.*

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EXERCISE

Question 1

"SVS Propcon" did not make a claim of ` 20 lacs in the return of income filed for A.Y. 2018-19 which was disallowed in the previous assessment year under section 43B. However, the said claim was also not considered by the Assessing Officer during assessment proceedings on the ground that no revised return was filed. Can the assessee now make such claim before the appellate authority?

Answer

Yes, the assessee is entitled to raise additional claims before the appellate authorities.

The restriction that an additional claim has to be made by filing a revised return applies only in respect of a claim made before the Assessing Officer. An assessee cannot make a claim before the Assessing Officer otherwise than by filing a revised return. It was so held by the Supreme Court in Goetze (India) Ltd v. CIT (2006) 284 ITR 323.

However, this restriction does not apply to an additional claim made before an appellate authority. The appellate authorities have jurisdiction to permit additional claims before them, though, the exercise of such jurisdiction is entirely the authorities' discretion. It was so held by the Bombay High Court in CIT v. Pruthvi Brokers & Shareholders (2012) 349 ITR 336.

Thus, an additional claim can be raised before the Appellate Authority even if no revised return is filed.

Question 2

Examine the correctness or otherwise of the following statements with reference to the provisions of the Income-tax Act, 1961:

(i) An appeal before Income-tax Appellate Tribunal cannot be decided in the event of difference of opinion between the Judicial Member and the Accountant Member on a particular ground.

(ii) A High Court does not have an inherent power to review an earlier order passed by it on merits.

Answer

(i) The statement given is not correct. As per the provisions of section 255, in the event of difference in opinion between the members of the Bench of the Income-tax Appellate Tribunal, the matter shall be decided on the basis of the opinion of the majority of the members. In case the members are equally divided, they shall state the point or points of difference and the case shall be referred by the President of the Tribunal for hearing on such points by one or more of the other members of the Tribunal. Such point or points shall be decided according to the opinion of majority of the members of the Tribunal who heard the case, including those who had first heard it.

(ii) **The statement given is *not* correct.** The Supreme Court, in CIT v. Meghalaya Steels Ltd. (2015) 377 ITR 112, observed that the power of review would inhere on High Courts, being courts of record under article 215 of the Constitution of India. There is nothing in article 226 of the Constitution to preclude a High Court from exercising the power of review which inheres in every court of plenary jurisdiction to prevent miscarriage of justice or to correct grave and palpable

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errors committed by it. The Supreme Court further observed that section 260A(7) does not purport in any manner to curtail or restrict the application of the provisions of the Code of Civil Procedure. Section 260A(7) only states that all the provisions that would apply qua appeals in the Code of Civil Procedure would apply to appeals under section 260A. The Supreme Court opined that this does not in any manner suggest either that the other provisions of the Code of Civil Procedure are necessarily excluded or that the High Court's inherent jurisdiction is in any manner affected.

Question 3

Does the Income-tax Appellate Tribunal have the following powers?

(i) Power to allow the assessee to urge any ground of appeal which was not raised by him before the Commissioner (Appeals);

(ii) Power to recall its own order.

Answer

(i) The Income-tax Appellate Tribunal has the power to entertain question raised for the first time. The Tribunal is not confined only to the issues arising out of the appeal before the Commissioner (Appeals). It has the power to allow the assessee to urge any ground not raised before the Commissioner (Appeals). However, the relevant facts in respect of such ground should be on record. The decision of the Supreme Court in the case of National Thermal Power Company Limited vs. CIT (1998) 229 ITR 383 (SC) supports this view.

(ii) The Delhi High Court, in Lachman Dass Bhatia Hingwala (P) Ltd. v. ACIT (2011) 330 ITR 243 (Delhi)(FB) observed that the justification of an order passed by the Tribunal recalling its own order is required to be tested on the basis of the law laid down by the Apex Court in Honda Siel Power Products Ltd. v. CIT (2007) 295 ITR 466, dealing with the Tribunal's power under section 254(2) to recall its order where prejudice has resulted to a party due to an apparent omission, mistake or error committed by the Tribunal while passing the order. Such recalling of order for correcting an apparent mistake committed by the Tribunal has nothing to do with the doctrine or concept of inherent power of review. It is a well settled provision of law that the Tribunal has no inherent power to review its own judgment or order on merits or reappreciate the correctness of its earlier decision on merits. However, the power to recall has to be distinguished from the power to review. While the Tribunal does not have the inherent power to review its order on merits, it can recall its order for the purpose of correcting a mistake apparent from the record.

When prejudice results from an order attributable to the Tribunal's mistake, error or omission, then it is the duty of the Tribunal to set it right. The Delhi High Court observed that the Tribunal, while exercising the power of rectification under section 254(2), can recall its order in entirety if it is satisfied that prejudice has resulted to the party which is attributable to the Tribunal's mistake, error or omission and the error committed is apparent.

Question 4

Can a rectification order under section 254 of the Income-tax Act, 1961 be passed by the Income-tax Appellate Tribunal beyond 6 months from the end of the month in which the order sought to be rectified was passed?

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Answer

The issue as to whether a rectification order can be passed by the Income-tax Appellate Tribunal under section 254 beyond six months from the end of the month in which order sought to be rectified was passed, has been addressed in Sree Ayyanar Spinning and Weaving Mills Ltd. v. CIT (2008) 301 ITR 434 (SC). Section 254(2), dealing with the power of the Appellate Tribunal to pass an order of rectification of mistakes, is in two parts. The first part refers to the suo motu exercise of the power of rectification by the Appellate Tribunal, whereas the second part refers to rectification on an application filed by the assessee or Assessing Officer bringing any mistake apparent from the record to the attention of the Appellate Tribunal.

If Income-tax Appellate Tribunal, suo moto, makes the rectification of its order, then the order has to be passed within 6 months from the end of the month in which the order sought to be rectified was passed. Where the application for rectification is made by the Assessing Officer or the assesse within 6 months from the end of the month in which the order sought to be rectified was passed, the Appellate Tribunal is bound to decide the application on merits and not on the ground of limitation i.e. order can be passed after expiry of 6 months from the end of the month in which the order sought to be rectified was passed. However, the application for rectification cannot be filed belatedly after 6 months from the end of the month in which the order sought to be rectified was passed. [Ajith Kumar Pitaliya vs ITO (2009) 318 ITR 182 (M.P.)]

Question 5

What do you mean by substantial question of law? Examine.

Answer

The expression "substantial question of law" has not been defined anywhere in the Act. However, it has acquired a definite meaning through various judicial pronouncements. The tests are:

(1) whether directly or indirectly it affects substantial rights of the parties; or

(2) the question is of general public importance; or

(3) whether it is an open question in the sense that issue is not settled by the pronouncement of the Supreme Court or Privy Council or by the Federal Court; or

(4) the issue is not free from difficulty; or

(5) it calls for a discussion for alternative view.

Question 6

Examine the correctness of the following statement:

"The Appellate Tribunal is empowered to grant indefinite stay for the demand disputed in appeals before it."

Answer

Section 254(2A) provides that the Appellate Tribunal, where it is possible, may hear and decide an appeal within a period of four years from the end of the financial year in which such appeal is filed.

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The Appellate Tribunal may, on merit, pass an order of stay in any proceedings relating to an appeal. However, such period of stay cannot exceed 180 days from the date of such order. The Appellate Tribunal has to dispose off the appeal within this period of stay.

Where the appeal has not been disposed off within this period and the delay in disposing the appeal is not attributable to the assessee, the Appellate Tribunal can further extend the period of stay originally allowed. However, the aggregate of period originally allowed and the period so extended should not exceed 365 days even if the delay in disposing of the appeal is not attributable to the assessee. The Appellate Tribunal is required to dispose off the appeal within this extended period. 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.

Therefore, the statement given in the question is not correct.

Question 7

Is Commissioner (Appeals) empowered to consider an appeal filed by an assessee challenging the order of assessment in respect of which the proceedings before the Settlement Commission abates? Examine.

Answer

Section 251(1) lists the powers of the Commissioner (Appeals) in disposing of an appeal. Clause (aa) of section 251(1) empowers the Commissioner (Appeals), 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.

Question 8

An Income-tax authority did not file an appeal to the Income-tax Appellate Tribunal against an order of the Commissioner (Appeals) decided against the Income-tax department on a particular issue in case of one assessee, Alpi for assessment year 2017-18 on the ground that the tax effect of such dispute was less than the monetary limit prescribed by CBDT. In assessment year 2018-19, similar issue arose in the assessments of Alpi and her sister Palki, which was decided by the Commissioner (Appeals) against the Department. Can the Income-tax department move an appeal to the Tribunal in respect of A.Y. 2018-19 against the orders of the Commissioner (Appeals) for Alpi and her sister Palki?

Answer

Under section 268A(1), the CBDT is empowered to issue orders, instructions or directions to the other income-tax authorities, fixing such monetary limits, as it may deem fit, to regulate filing of appeal or application for reference by any income-tax authority.

Under section 268A(2), 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 above-mentioned

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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 the same assessee for any other assessment year or any other assessee for the same or any other assessment year. 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.

In view of above provision, it would be in order for the Income-tax Department to move an appeal to the Tribunal against the orders of the CIT(A) in respect of A.Y. 2018-19 both for Alpi and Palki.

Question 9

A petition for stay of demand was filed before ITAT by XYZ Ltd. in respect of a disputed demand for which appeal was pending before it, on which stay was granted by the ITAT vide order dated 1.1.2017. The bench could not function thereafter till 1.2.2018 and therefore, the disputed matter could not be disposed off. The Assessing Officer attached the bank account on 16.2.2018 and recovered the amount of ` 15 lacs against the arrear demand of ` 25 lacs. The assessee requested the Assessing Officer to refund back the amount as it holds stay over it. The Assessing Officer rejected the contention of the assessee. Now the assessee seeks your opinion.

Answer

The Appellate Tribunal may, on merit, pass an order of stay in any proceedings relating to an appeal. However, such period of stay cannot exceed 180 days from the date of such order. The Appellate Tribunal has to dispose off the appeal within this period of stay. Where the appeal has not been disposed off within this period and the delay in disposing the appeal is not attributable to the assessee, the Appellate Tribunal can further extend the period of stay originally allowed. Section 254(2A) provides that 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.

Accordingly, even if an appeal is not heard by the bench, say, due to the bench not functioning or due to the department seeking adjournment, the stay granted by the Appellate Tribunal shall stand vacated after the period of 365 days, inspite of the assessee having taken all steps to ensure speedy disposal of the appeal and having a good prima facie case.

In the present case, the period of 365 days has expired on 31.12.2017, after which date the order of stay stands vacated. Accordingly, the recovery of ` 15 lacs against the arrear demand of ` 25 lacs made by the Assessing Officer is in order.

Question 10

An assessee who had been served with an order of assessment passed under section 143(3) on 1.1.2018 had filed an application against this order before the CIT as per section 264 on 11.1.2018. However, the CIT refused to entertain the application on the pretext of premature application. Assessee seeks your opinion.

Answer

An assessee, who is aggrieved by the order of the Assessing Officer under section 143(3) passed on 1.1.2018, had moved an application for revision of order under section 264 on 11.1.2018. The order

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passed by the Assessing Officer under section 143(3) is an order appealable before the Commissioner (Appeals). The time limit for filing an appeal is 30 days from the date of order i.e., upto 31.1.2018. This time limit had not expired on 11.1.2018 and the assessee had also not waived his right of appeal while filing the application for revision on 11.1.2018 before the Commissioner of Income-tax. The application filed before the Commissioner of Income-tax for revision under section 264 by the assessee will only be considered when the conditions specified under section 264(4) have been complied with. One of the conditions is that the Commissioner shall not revise any order where an appeal against the order lies to the Commissioner (Appeals) or Appellate Tribunal and the time within which such appeal may be made has not expired, unless the assessee has waived his right of appeal. In the present case, the time limit had not expired on 11.1.2018 and the assessee had also not waived the right of appeal while filing the application for revision before the Commissioner of Income-tax on 11.1.2018 under section 264. Therefore, the Commissioner's refusal to entertain such application is correct.

Note : In practical situations, the Commissioner could have kept the proceedings in abeyance till the expiry of the time prescribed for filing appeal by the assessee and thereafter, could have assumed jurisdiction for making revision besides taking an undertaking from the assessee for waiving his right of appeal. In reality, taxpayers usually will not prefer revision in such short time period nor would the Commissioner reject the application, the moment it is received by him.

Question 11

(a) The Commissioner of Income-tax issued notice to revise the order passed by an Assessing Officer under section 143. During the pendency of proceedings before the Commissioner, on the basis of material gathered during survey under section 133A after issue of the first notice, the Commissioner of Income-tax issued a second notice, the contents of which were different from the contents of the first notice. Examine whether the action of the Commissioner is justified as to the second notice.

(b) Examine the circumstances where the appellant shall be entitled to produce additional evidence, oral or documentary, before the Commissioner of Income-tax (Appeals) other than the evidence produced during the proceedings before the Assessing Officer.

Answer

(a) The action of the Commissioner in issuing the second notice is not justified. The term "record" has been defined in clause (b) of Explanation to section 263(1). According to this definition "record" shall include and shall be deemed always to have included all records relating to any proceeding under the Act available at the time of examination by the Commissioner. In other words, the information, material, report etc. which were not in existence at the time the assessment was made and came into existence afterwards can be taken into consideration by the Commissioner for the purpose of invoking his jurisdiction under section 263(1). However, at the same time, in view of the express provisions contained in clause (b) of the Explanation to section 263(1), such information, material, report etc. can be relied upon by the Commissioner only if the same forms part of record when the action under section 263 is taken by the Commissioner,

Issuance of a notice under section 263 succeeds the examination of record by Commissioner. In the present case, the Commissioner initially issued a notice under section 263, after the examination of the record available before him. The subsequent second notice was on the basis of material collected under section 133A, which was totally unrelated and irrelevant to the

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issues sought to be revised in the first notice. Accordingly, the material on the basis of which the second notice was issued could not be said to be "record" available at the time of examination as emphasized in Explanation (b) to section 263(1).

(b) As per Rule 46A(1) of the Income-tax Rules 1962, an appellant shall be entitled to produce before the Commissioner (Appeals), evidence, either oral or documentary, other than the evidence produced by him during the course of proceedings before the Assessing Officer, only in the following circumstances -

(a) where the Assessing Officer has refused to admit evidence which ought to have been admitted; or

(b) where the appellant was prevented by sufficient cause from producing the evidence which he was called upon to produce by the Assessing Officer; or

(c) where the appellant was prevented by sufficient cause from producing before the Assessing Officer any evidence which is relevant to any ground of appeal; or

(d) where the Assessing Officer has made the order appealed against without giving sufficient opportunity to the appellant to adduce evidence relevant to any ground of appeal.

Further, no evidence shall be admitted unless the Commissioner (Appeals) records in writing the reasons for its admission.

Question 12

Examine the correctness or otherwise of the following propositions in the context of the Income-tax Act, 1961:

(a) The powers of the Commissioner of Income-tax (Appeals) to enhance the assessment are plenary and quite wide.

(b) At the time of hearing of rectification application, the Income-tax Appellate Tribunal can re-appreciate the evidence produced during the proceedings of the appeal hearing.

(c) The High Court cannot interfere with the factual finding recorded by the lower authorities and the Tribunal, without any valid reasons.

Answer

(a) The proposition is correct in law. The Supreme Court has, in CIT vs. McMilan & Co. (1958) 33 ITR 182 and CIT vs. Kanpur Coal Syndicate (1964) 53 ITR 225, held that in disposing of an appeal before him, the appellate authority can travel over a whole range of the assessment order. The scope of his powers is co-terminus with that of the Assessing Officer. He can do what the Assessing Officer can do and can also direct him to do, what he has failed to do. He can assess income from sources which have been considered by the Assessing Officer but not brought to tax. He can consider every aspect of the assessment order and give appropriate relief.

The Allahabad High Court has, in CIT v. Kashi Nath Chandiwala (2006) 280 ITR 318, held that the appellate authority is empowered to consider and decide any matter arising out of the proceedings in which the order appealed against was passed notwithstanding the fact that such matter was not raised before him by the assessee. The Commissioner (Appeals) is entitled to direct additions in respect of items of income not considered by the Assessing Officer.

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Further, the Apex Court has, in the case of Jute Corporation of India Ltd. vs. CIT (1991) 187 ITR 688, held that the appellate authority is vested with all the plenary powers which the subordinate authority may have in the matter.

Thus, the powers of the Commissioner of Income-tax (Appeals) in enhancing the assessment are very wide and plenary.

(b) The proposition is not correct as per law. This is because section 254(2) specifically empowers the Appellate Tribunal to amend any order passed by it, either suo-moto or on an application made by the assessee or Assessing Officer, with a view to rectify any mistake apparent from record, at any time within 6 months from the end of the month of the order sought to be amended.

The powers of the Tribunal under section 254(2) relating to rectification of its order are very limited. Such powers are confined to rectifying any mistake apparent from the record. The mistake has to be such that for which no elaborate reasons or inquiry is necessary. Accordingly, the re-appreciation of evidence placed before the Tribunal during the course of the appeal hearing is not permitted. It cannot re-adjudicate the issue afresh under the garb of rectification [CIT vs. Vardhman Spinning (1997) 226 ITR 296 (P & H), CIT v. Ballabh Prasad Agarwalla (1998) 233 ITR 354 (Cal.) & Niranjan & Co. Ltd. v. ITAT (1980) 122 ITR 519 (Cal.)]

(c) The proposition is correct in law. A finding of fact cannot be disturbed by the High Court in exercise of its powers under section 260A. The Income-tax Appellate Tribunal is the final fact finding authority and the findings of fact recorded by the Tribunal can be interfered with by the High Court under section 260A only on the ground that the same were without evidence or material, or if the finding is contrary to the evidence, or is perverse or there is no direct nexus between conclusion of fact and the primary fact upon which that conclusion is based.

In CIT vs. P. Mohanakala (2007) 291 ITR 278 and M. Janardhana Rao v. Joint CIT (2005) 273 ITR 50, the Apex Court observed that the High Court had set aside the factual findings of the lower authorities and the Tribunal without any valid reason. The Apex Court held that the findings of fact could not be interfered with by the High Court without carefully considering the facts on record, the surrounding circumstances and the material evidence. There is no scope for interference with the factual findings, unless the findings are per se without reason or basis, perverse and/or contrary to the material on record.

Hence, only if the issue gives rise to a substantial question of law, an appeal shall lie before the High Court.

Question 13

Answer the following in the context of provisions contained in the Income-tax Act, 1961:

The assessment for A.Y. 2014-15 was completed as per section 143(3) considering the various claims so made by the assessee on 23.12.2015. Subsequently, this was reopened under section 147 on certain issues, but excluding the claim of the assessee as to "Lease Equalisation Fund". The order of reassessment was passed on 18.11.2016. The Commissioner within the powers vested under section 263 passed an order on 11.4.2018 rejecting the claim of assessee as to "Lease Equalisation Fund". The assessee challenges that the action of the CIT is not sustainable because the same was barred by limitation.

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Answer

This issue was settled by the Supreme Court in CIT v. Alagendran Finance Ltd. (2007) 293 ITR 1. The Supreme Court observed that though there was no doubt that once an order of assessment is reopened, the previous assessment will be held to be set aside and the whole proceedings would start afresh, however, it would not mean that even when the subject-matter of reassessment is distinct and different, the entire proceeding would be deemed to have been reopened. The doctrine of merger would apply only in a case where the subject-matter of reassessment and the subject- matter of assessment are the same. However, in this case, the revision proceedings related to Lease Equalisation Fund, which was not the subject matter of reassessment. Therefore, the doctrine of merger does not apply in this case.

Section 263(2) provides no order shall be made under section 263(1) after the expiry of two years from the end of the financial year in which the order sought to be revised was passed. The period of limitation as referred to in section 263(2) relates to the assessment in which the claim of the assessee as to Lease Equalisation Fund was considered by the Assessing Officer. This issue was not the subject matter of reassessment proceedings.

Accordingly, the period of limitation shall be reckoned with reference to the original assessment order and not from the date of the order of reassessment. Therefore, in this case, the revision proceedings are barred by limitation since the original assessment order was made on 23.12.2015 and the revision should have been made by 31.3.2018.

Note – The difference between partial merger and total merger has been explained for the understanding of the students. The doctrine of partial merger would apply in the case of section 263.

The third proviso in section 147, inserted by Finance Act, 2008, 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.

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.

Question 14

An assessee, who is aggrieved by all or any of the following orders, is desirous to know the available remedial recourse and the time limit against each under the Income-tax Act, 1961:

(i) passed under section 143(3) by the Assessing Officer.

(ii) passed under section 263 by the Commissioner of Income-tax.

(iii) passed under section 272A by the Director General.

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(iv) passed under section 254 by the ITAT.

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Answer

(i) An assessee, aggrieved by the order passed under section 143(3) by the Assessing Officer, can file an appeal before the Commissioner of Income-tax (Appeals) under section 246A(1) within 30 days of the date of service of the notice of demand relating to the assessment. However, where the assessee does not want to prefer an appeal, then he can move a revision petition before the Principal Commissioner or Commissioner of Income-tax under section 264 within a period of one year from the date of on which the order was communicated to him or the date on which he otherwise came to know of it, whichever is earlier.

(ii) An assessee, aggrieved by the order passed under section 263 by the Commissioner of Income-tax, can file an appeal to Income-tax Appellate Tribunal under section 253(1)(c) within 60 days of the date on which the order sought to be appealed against is communicated to the assessee.

(iii) An assessee, aggrieved by the order passed under section 272A by the Director General, can file an appeal before the Income-tax Appellate Tribunal under section 253(1)(c) within 60 days of the date on which the order sought to be appealed against is communicated to the assessee.

(iv) An assessee, aggrieved by the order passed under section 254 by the Income-tax Appellate Tribunal, can file an appeal before the High Court under section 260A within 120 days from the date of receipt of order of Income-tax Appellate Tribunal, only where the order gives rise to a substantial question of law.

Question 15

Who can file memorandum of cross-objections before the Income-tax Appellate Tribunal? What is the time limit? What is the fee for filing memorandum of cross objections?

Answer

Section 253(4) of the Income-tax Act, 1961 gives the respondent (assessee or the Assessing Officer), in every appeal filed before the Income-tax Appellate Tribunal, a right to file a memorandum of cross-objections against any order of the Commissioner (Appeals). This right of filing a memorandum of cross-objections is an independent right given to the respondent in an appeal and is in addition to the right of appeal which may or may not be exercised by the assessee or the Assessing Officer under section 253(1) or section 253(2). The memorandum of cross-objections has to be in the prescribed form and verified in the prescribed manner and has to be filed within 30 days of the receipt of notice of the appeal. The Tribunal is empowered to permit filing of memorandum of cross-objections after the expiry of the prescribed period if sufficient cause is shown. Such memorandum of cross-objections will be disposed of by the Appellate Tribunal as if it were an appeal presented within the time specified in section 253(3). There is no fee for filing a memorandum of cross-objections.

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DT QUESTION BANK BY YNB

SIGNIFICANT SELECT CASES

1. **Can an assessee make an additional/new claim before an appellate authority, which was not claimed by the assessee in the return of income (though he was legally entitled to), otherwise than by way of filing a revised return of income?**

   CIT v. Pruthvi Brokers & Shareholders (2012) 349 ITR 336 (Bom.)

   High Court's Observations: While considering the above mentioned issue, the Bombay High Court observed the decision of the Supreme Court, in the case of Jute Corporation of India Ltd. v. CIT (1991) 187 ITR 688 and National Thermal Power Corporation. Ltd v. CIT (1998) 229 ITR 383, that an assessee is entitled to raise additional claims before the appellate authorities. The appellate authorities have jurisdiction to permit additional claims before them, however, the exercise of such jurisdiction is entirely the authorities' discretion.

   Also, the High Court considered the decision of the Apex Court in the case of Addl. CIT v. Gurjargravures (P.) Ltd. (1978) 111 ITR 1, wherein it was held that in case an additional ground was raised before the appellate authority which could not have been raised at the stage when the return was filed or when the assessment order was made, or the ground became available on account of change of circumstances or law, the appellate authority can allow the same.

   The Supreme Court, in the case of Goetze (India) Ltd v. CIT (2006) 157 Taxmann 1, held that the assessee cannot make a claim before the Assessing Officer otherwise than by filing an application for the same. The additional claim before the Assessing Officer can be made only by way of filing revised return of income.

   The decision in the above mentioned case, however, does not apply in this case, since the Assessing Officer is not an Appellate Authority.

   High Court's Decision: Therefore, in the present case, the Bombay High Court, considering the above mentioned decisions, held that additional grounds can be raised before the Appellate Authority even otherwise than by way of filing return of income. However, in case the claim has to be made before the Assessing Officer, the same can only be made by way of filing a revised return of income.

2. **Does the Appellate Tribunal have the power to review or re-appreciate the correctness of its earlier decision under section 254(2)?**

   CIT v. Earnest Exports Ltd. (2010) 323 ITR 577 (Bom.)

   High Court's Observations: In this case, the High Court observed that the power under section 254(2) is limited to rectification of a mistake apparent on record and therefore, the Tribunal must restrict itself within those parameters. **Section 254(2) is not a carte blanche for the Tribunal to change its own view by substituting a view which it believes should have been taken in the first instance.** Section 254(2) is not a mandate to unsettle decisions taken after due reflection.

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High Court's Decision: In this case, the Tribunal, while dealing with the application under section 245(2), virtually reconsidered the entire matter and came to a different conclusion. This amounted to a reappreciation of the correctness of the earlier decision on merits, which is beyond the scope of the power conferred under section 254(2).

3. Can the Tribunal exercise its power of rectification under section 254(2) to recall its order in entirety, where there is a mistake apparent from record?
Lachman Dass Bhatia Hingwala (P) Ltd. v. ACIT (2011) 330 ITR 243 (Delhi)(FB)

High Court's Observations: On this issue, the Delhi High Court observed that the justification of an order passed by the Tribunal recalling its own order is required to be tested on the basis of the law laid down by the Apex Court in Honda Siel Power Products Ltd. v. CIT (2007) 295 ITR 466, dealing with the Tribunal's power under section 254(2) to recall its order where prejudice has resulted to a party due to an apparent omission, mistake or error committed by the Tribunal while passing the order. Such recalling of order for correcting an apparent mistake committed by the Tribunal has nothing to do with the doctrine or concept of inherent power of review. It is a well settled provision of law that the Tribunal has no inherent power to review its own judgment or order on merits or reappreciate the correctness of its earlier decision on merits. However, the power to recall has to be distinguished from the power to review. While the Tribunal does not have the inherent power to review its order on merits, it can recall its order for the purpose of correcting a mistake apparent from the record.

The Apex Court, while dealing with the power of the Tribunal under section 254(2) in Honda Siel Power Products Ltd., observed that one of the important reasons for giving the power of rectification to the Tribunal is to see that no prejudice is caused to either of the parties appearing before it by its decision based on a mistake apparent from the record. When prejudice results from an order attributable to the Tribunal's mistake, error or omission, then it is the duty of the Tribunal to set it right. In that case, the Tribunal had not considered the material which was already on record while passing the judgment. The Apex Court took note of the fact that the Tribunal committed a mistake in not considering material which was already on record and the Tribunal acknowledged its mistake and accordingly, rectified its order.

The above decision of the Apex Court is an authority for the proposition that the Tribunal, in certain circumstances can recall its own order and section 254(2) does not totally prohibit so. In view of the law laid down by the Apex Court in that case, the decisions rendered by the High Courts in certain cases to the effect that the Tribunal under no circumstances can recall its order in entirety do not lay down the correct statement of law.

High Court's Decision: Applying the above-mentioned decision of the Apex Court to this case, the Delhi High Court observed that the Tribunal, while exercising the power of rectification under section 254(2), can recall its order in entirety if it is satisfied that prejudice has resulted to the party which is attributable to the Tribunal's mistake, error or omission and the error committed is apparent.

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Note *- In deciding whether the power under section 254(2) can be exercised to recall an order in entirety, it is necessary to understand the true principle laid down in the Apex Court decision. A decision should not be mechanically applied treating the same as a precedent without appreciating the underlying principle contained therein. In this case, the Apex Court decision was applied since prejudice had resulted to the party on account of the mistake of the Tribunal apparent from record.*

4. Does the High Court have an inherent power under the Income-tax Act, 1961 to review an earlier order passed on merits?

CIT v. Meghalaya Steels Ltd. (2015) 377 ITR 112 (SC)

Facts of the case: In this case, the High Court had considered whether deduction is allowable under section 80-IB on transport subsidy and interest subsidy and on the central excise duty refund received by it. Finally, after stating that two substantial questions of law arose under section 260A, the High Court proceeded to answer the two questions. Against this judgement, the assessee filed a review petition whereupon the Division Bench of the High Court recalled its entire order for adjudication on the ground that it had not formulated the substantial questions of law before hearing of the appeal and had not invited the parties to have their say in the matter which amounted to denial of opportunity of effective hearing to the parties concerned, particularly, the review petitioners. Further, it had on an earlier occasion prior to passing the order, reserved the judgement on whether substantial questions of law in fact existed at all.

Revenue's contention vis-à-vis Assessee's contention: The Revenue contended that, by virtue of section 260A(7), only those provisions of the Civil Procedure Code could be looked into for the purposes of section 260A as were relevant to the disposal of appeals, and since the review provision contained in the Code of Civil Procedure is not so referred to, the High Court would have no jurisdiction under section 260A to review such judgment. The assessee- petitioner, however, contended that High Courts being courts of record under article 215 of the Constitution of India, the power of review would in fact inhere in them.

Supreme Court's Observations: The Supreme Court concurred with the assessee's submission that High Courts being courts of record under article 215 of the Constitution of India, the power of review would inhere in them. Further, it noted that in another case[1], in a slightly different context while dealing with power of review of writ petitions filed under article 226, the Supreme Court had observed that there is nothing in article 226 of the Constitution to preclude a High Court from exercising the power of review which inheres in every court of plenary jurisdiction to prevent miscarriage of justice or to correct grave and palpable errors committed by it. In that case, the High Court had entertained the second petition since the interested parties were not given an effective opportunity of being heard, before passing the

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[1] Shivdeo Singh v. State of Punjab AIR 1963 SC 1909

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judgement; therefore, keeping in mind the requirement of the principles of natural justice, the High Court had exercised its inherent power of review.

Supreme Court's Decision: The Supreme Court went ahead to further observe that it is clear on a cursory reading of section 260A(7), that it does not purport in any manner to curtail or restrict the application of the provisions of the Code of Civil Procedure. Section 260A(7) only states that all the provisions that would apply qua appeals in the Code of Civil Procedure would apply to appeals under section 260A. That does not in any manner suggest either that the other provisions of the Code of Civil Procedure are necessarily excluded or that the High Court's inherent jurisdiction is in any manner affected.

5. **Can High Court exercise its inherent power to recall its order by exercising jurisdiction under section 260A(7) read with the relevant Rule of the Code of Civil Procedure, 1908 even if that order is not an ex-parte order?**

CIT v. Subrata Roy (2016) 385 ITR 570 (SC)

Facts of the case: In the present case, the High Court of Allahabad has recalled its final order dated August 27, 2013 by exercising jurisdiction under section 260A(7) read with the relevant rule of the Code of Civil Procedure,1908. The High Court, while recalling its order, took note that section 260A(7) inserted by the Finance Act, 1999 provides that the provisions of the Code of Civil Procedure, 1908 relating to appeals to the High Court shall apply in the case of appeal under section 260A of the Income-tax Act, 1961. The relevant rule of the Code of Civil Procedure,1908 provides that **where an appeal is heard ex-parte and the judgment is pronounced against the respondent,** he may apply to the court to re-hear the appeal. Also, where the notice is not served or the defendant was prevented by the sufficient cause from appearing, the court shall re-hear the appeal on such terms as to costs or otherwise as it thinks fit to impose upon him.

The High Court contended that it is empowered to exercise this inherent power. Therefore, vide order dated 21.2.2014, the High Court had recalled its order dated August 27, 2013, on the ground that it had passed its order rejecting the request of the assessee for a day's adjournment since the senior advocate on behalf of the assessee, was to come from Mumbai next day and thus, the applicant could not advance any argument.

Supreme Court's Observations and Decision: The Apex Court noted that the assessee had participated in the hearing of the appeals before High Court which is apparent from the various parts of the order dated 27.08.2013.

The Apex Court held that the order passed by the High Court is not an ex-parte order for invoking the provisions of the Code of Civil Procedure, 1908, since the order of the High Court contains the submissions of the counsel of the assessee (though not that of the senior counsel for whose presence a short adjournment was prayed). Therefore, the High

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Court did not have the jurisdiction to recall the order passed by it previously. The inherent power under the Code of Civil Procedure, 1908 is hedged by certain pre-conditions and unless the pre-conditions are satisfied the power thereunder cannot be exercised. Accordingly, the Supreme Court set aside the order dated 21.2.2014 of the High Court.

6. Can revision under section 263 be made on the ground that the order is passed without making inquiries or verification which should have been made?

CIT v. Amitabh Bachchan (2016) 384 ITR 200 (SC)

Facts of the case: The assessee filed his return of income and subsequently, filed a revised return in which he claimed 30% of gross professional receipts amounting to Rs.3.17 crore as expenditure towards his personal security. When the Assessing Officer asked for the details of expenditure, the assessee replied that the expenses were for security for the personal safety of the assessee and the payments were made out of cash balances. Thereafter, by way of a letter, the assessee informed the Assessing Officer that the claim was made on a belief that it was allowable but as it is not feasible to substantiate the claim, the revised return may be taken to be withdrawn. The Assessing Officer had proposed to treat the expenditure claim as unexplained expenditure under section 69C but after considering the assessee's reply, did not pursue the matter.

After the assessment was finalized, the Commissioner issued show cause notice under section 263 containing the grounds on which the assessment order was proposed to be revised. On getting the replies to the show cause notice, the Commissioner set aside the order of assessment and directed a fresh assessment on the principal ground that requisite and due enquiries were not made by the Assessing Officer prior to finalization of the assessment. On this basis, the Commissioner came to the conclusion that the assessment order in question was erroneous and prejudicial to the interests of the Revenue warranting exercise of power under section 263. In his order, the Commissioner of Income-tax did not record any finding on the several issues mentioned in the show cause notice whereas he recorded conclusions adverse to the assessee in respect of issues which were not specifically mentioned in the show cause notice. However, few of the issues, including the claim of additional expenses in the revised return were common to the show cause notice as well as the revisionary order.

Appellate Authorities' view: The Tribunal opined that in respect of the issues not mentioned in the show-cause notice, the findings as recorded in the revisional order under section 263 would be considered as breach of principles of natural justice, since the Commissioner of Income-tax cannot go beyond the issues mentioned in the show-cause notice. Accordingly, the Tribunal reversed the order of the suo motu revision of order under section 263.

The High Court also dismissed the appeal of the Revenue holding that as the Commissioner had gone beyond the scope of the show cause notice and had dealt with issues not covered or mentioned in the notice the revisional order which was in violation of the principles of natural justice. The Court also observed that the question whether the Assessing Officer had made

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sufficient enquiries about the assessee's claim made in the revised return was a pure question of fact and cannot be examined under section 260A.

Supreme Court's Observations: The Apex Court noted that to exercise jurisdiction under section 263 the requirement is that the order passed by the assessing authority is erroneous and prejudicial to the interests of the revenue. Section 263 does not require any specific show cause notice to be served on the assessee. What is required is granting of opportunity to the assessee of being heard before making the revision order. Failure to give such an opportunity would render the revisionary order legally fragile not on the ground of lack of jurisdiction but on the ground of violation of principles of natural justice.

The Supreme Court observed that the Tribunal had not recorded any finding that in course of the suo moto revisionary proceedings, the opportunity of hearing was not afforded to the assessee and that the assessee was denied an opportunity to contest the facts on the basis of which the Commissioner had come to the conclusions as recorded in the order under section 263.

In the course of revision, the documents and books of accounts overlooked in the assessment proceedings were considered and at every stage of revisionary proceeding, the authorized representative of the assessee had appeared and had full opportunity to contest the basis on which the revisionary authority was proceeding in the matter.

Where the Commissioner had come its conclusions on the basis of the record of the assessment proceedings which was open for scrutiny by the assessee and available to his authorized representative at all times, there is no breach of the requirement to give a reasonable opportunity of being heard as required under section 263.

Further, it also observed that when the Assessing Officer has dropped the investigation of the claim of expenses, it does not preclude the Commissioner of Income-tax from looking in to the same. Making a claim which would prima facie disclose that the expenses in respect of which deduction had been claimed had been incurred and thereafter, withdrawing the claim gave rise to the necessity of further enquiry in the interests of the Revenue. The notice issued under section 69C of the Act could not have been simply dropped on the ground that the claim had been withdrawn.

Supreme Court's Decision: The Apex Court, accordingly, held that the order of the Tribunal setting aside the revisional order on the ground that it went beyond the show cause notice was not sustainable. It further held that the High Court having failed to fully deal with the matter, its order was not tenable.

***Note** – As per Explanation 2 to section 263(1), inserted by the Finance Act, 2015, with effect from 01.06.2015, an order passed by the Assessing Officer shall be deemed to be erroneous in so far as it is prejudicial to the interest of the revenue, if in the opinion of the Principal Commissioner or Commissioner, the order is passed without making inquiries or verification which should have been made. The rationale of the above court ruling is, thus, also in line with Explanation 2 to Section 263(1).*

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7. Can mere non-mention or non-discussion of enquiry made by the Assessing Officer in the assessment order justify invoking revisionary jurisdiction under section 263?

CIT v. Krishna Capbox (P) Ltd (2015) 372 ITR 310 (All)

Facts of the case: The assessee filed its return of income declaring total income of ` 8.15 lakhs. The return was processed under section 143(1) and later, the case was selected for scrutiny and statutory notice under section 143(2) was issued. During the course of scrutiny, the Assessing Officer raised certain queries which were answered by the assessee. The Assessing Officer, after being satisfied with the replies given, completed the assessment by accepting the declared income. Subsequently, the Commissioner invoked revisionary jurisdiction under section 263 by holding that the Assessing Officer had not made enquiry on certain aspects, such as -

(i) Non-verification of source of investment in respect of addition in fixed assets;

(ii) Non-confirmation of sundry creditors by the assessee;

(iii) Non-enquiry of unsecured loan by the Assessing Officer;

(iv) Not obtaining the copy of bank statements;

(v) Non-verification of genuineness of shareholders;

(vi) Deduction of freight paid without deduction of tax at source.

Assessee's contention vis-a-vis Revenue's Contention: The assessee contended that all the aspects contested by the Commissioner were enquired by the Assessing Officer. The Revenue took the defence that no enquiry was made by the Assessing Officer in respect of the issues set out in the notice issued under section 263 and hence, revisionary jurisdiction was correctly assumed.

Tribunal's view: The Tribunal noted that all necessary enquiries were made and all the requisite documents were placed in the paper book. Once enquiry was made, mere non- discussion or non-mention in the assessment order cannot lead to the assumption that the Assessing Officer did not apply his mind or that he had not made any enquiry on the subject for invoking section 263.

High Court's Observations: The High Court noted the Bombay's High Court's view in Cellular Ltd. v. DCIT (2008) 301 ITR 407 that if a query is raised during the assessment proceedings and responded to by the assessee, the mere fact that it is not dealt with in the assessment order would not lead to a conclusion that no mind had been applied to it.

High Court's Decision: The High Court concurred with the decision of the Tribunal and held that since the relevant enquiries and replies are available on 'record' (i.e., the paper book), the Commissioner cannot invoke revisionary jurisdiction merely because there was no mention of such enquiry and verification in the assessment order.

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Note - The Finance Act, 2015 inserted Explanation 2 to section 263(1) to clarify, inter alia, that an order passed by the Assessing Officer shall be deemed to be erroneous in so far as it is prejudicial to the interests of the revenue, if in the opinion of the Principal Commissioner or Commissioner, the order is passed without making inquiries or verification which should have been made.

The rationale of this ruling would hold good even after insertion of Explanation 2 to section 263(1), since in this case, the Tribunal has recorded a finding of fact that necessary enquiries have been made by the Assessing Officer even though the same was not specifically mentioned in the assessment order. Mere non-discussion or non-mention about the enquiry made by the Assessing Officer in the assessment order cannot be a ground for invoking revisionary jurisdiction under section 263.

8. Can the Commissioner invoke revisionary jurisdiction under section 263, when the subject matter of revision (i.e., whether the manner of allocation of revenue amongst the members of AOP would affect the allowability and/or quantum of deduction under section 80-IB) has been decided by the Commissioner (Appeals) and the same is pending before the Tribunal?

CIT v. Fortaleza Developers (2015) 374 ITR 510 (Bom)

Facts of the case: The assessee, an Association of Person (AOP) consisting of promoters and builders, was constituted by means of an agreement dated April 29, 2003 between M/s Raviraj Kothari and Co. (RRK) and M/s Sanand Properties Pvt. Ltd. (SPPL). The AOP filed its return of income for the assessment year 2007-08 declaring total income of ` 4.14 lakhs after claiming deduction under section 80-IB(10) of ` 1454.47 lakhs. The assessment was completed under section 143(3) disallowing fully the claim of deduction under section 80-IB(10). The assessee preferred an appeal before Commissioner (Appeals) who held that the assessee had fulfilled all the conditions laid down in section 80-IB(10) and hence, directed the Assessing Officer to allow the deduction.

The order of Commissioner (Appeals) was challenged before the Tribunal by the Revenue. During the pendency of the appeal before the Tribunal, the Commissioner issued a notice under section 263 asking the assessee to show cause as to why the assessment order should not be set aside. The notice under section 263 specified that the method of allocation of revenue gave the assessee undue benefit by way of a higher claim of deduction under section 80-IB(10) contrary to clause (7) of the AOP agreement.

Clause (7) of the agreement laid down that SPPL shall be entitled to 35% of the amount received from the purchasers of the housing units. Out of the balance 65% of the said receipts, all required and relevant expenditure for the purpose of the business of the AOP shall be met with and whatever net balance remains thereafter, shall be determined as the share of income of RRK.

On perusal of clause (7) of the agreement, the Commissioner contended that share of revenue pertaining to SPPL was not eligible for deduction under section 80-IB(10). Accordingly, the

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Commissioner set aside the assessment order of the assessee and directed to recompute the income on the basis of the clause (7) of the AOP agreement. The assessee challenged the revision order passed by the Commissioner under section 263 before the Tribunal.

Appellate Authorities' Views: The Tribunal observed that the quantum of deduction under section 80-IB(10) will depend upon the income earned from the project in question. The quantum of deduction will not depend on the mode of distribution of shares amongst members of the association of persons as income of association of persons is taxable at the maximum marginal rate. It is also observed by the Tribunal that the allowability or otherwise of deduction under section 80-IB(10) is not dependent upon the manner in which the profit has been distributed amongst the members of the AOP but is dependent upon the income earned from an eligible project and the fulfilment of the conditions laid down in the section. Also, the deduction is available to an undertaking and not to the individual constituent of an undertaking. The Tribunal further held that the Commissioner cannot exercise jurisdiction under section 263 in respect of deduction under section 80-IB, which was the subject matter of appeal.

High Court's Views: The High Court took note of all the facts and sequence of events with regard to the matter in appeal. The Court was of the view that the contract between the two parties was self-explanatory and the interpretation placed by the assessee on clause (7) and claiming deduction under section 80-IB(10) is in order.

High Court's Decision : When the order of the first appellate authority is complete and the appeal is pending before the Tribunal, the Commissioner is precluded from invoking section 263 for revision of the very same matter decided by the first appellate authority since clause (c) of the Explanation 1 to section 263 debars the same.

Accordingly, the High Court held that the order passed by the Assessing Officer got merged with the order of the first appellate authority. The very same issue cannot be revised by invoking revisionary jurisdiction under section 263.

9. Can an assessee, objecting to the reassessment notice issued under section 148, directly approach the High Court in the normal course contending that such reassessment proceedings are apparently unjustified and illegal?

Samsung India Electronics P. Ltd. v. DCIT (2014) 362 ITR 460 (Del.)

Facts of the case: In the present case, Samsung Electronics Co. Ltd., the Korean Company was subjected to regular assessment for the assessment year 2006-07. The assessment order was passed, pursuant to the directions under section 144C(5) made by the Disputes Resolution Panel. For the same assessment year, i.e., A.Y.2006-07, assessee was issued a reassessment notice dated March 30, 2013 under section 148. Against this reassessment notice, assessee filed a writ petition before the High Court.

High Court's Observations: The High Court observed the Apex court ruling in the case of GKN Driveshafts (India) Ltd. v. ITO [2003] 259 ITR 19 (SC), wherein, it was laid down that

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when a notice under section 148 is issued, the proper course of action for the noticee is to file a return and if he so desires, to seek reasons for issuing notices. The Assessing Officer is bound to furnish reasons within a reasonable time. On receipt of the reasons, the noticee is entitled to file objections to issuance of notice and the Assessing Officer is bound to dispose of the objections by passing a speaking order.

The High Court noted that the assessee has not filed objections before the Assessing Officer and has directly approached the court by way of the writ petition. On this issue, the assessee contended that they were justified in approaching the High Court directly as the reassessment proceedings ex facie were unjustified and illegal. The assessee relied upon the decision of the Delhi High Court in Techspan India P. Ltd. v. ITO [2006] 283 ITR 212 (Delhi) in which reference was made to the decision of the Gujarat High Court in Garden Finance Ltd. v. Asst. CIT [2004] 268 ITR 48 (Guj), wherein it was observed that the exercise of the powers under section 148 may be so arbitrary or mala fide that the court may entertain the petition without requiring the assessee to approach the Assessing Officer, but such a case was an exception and not a rule. In Techspan India P. Ltd.'s case, the High Court had given concurrent reasons and made observations when a writ court should interfere. However, there is no need to go into the said question and controversy in the present case, since it does not occasion or require a different treatment from the procedure followed in other cases in which re-assessment proceedings were/are initiated.

High Court's Decision: The High Court, thus, held that it will not be appropriate and proper in the facts of the present case to permit and allow the petitioner to bypass and forgo the procedure laid down by the Supreme Court in *GKN Driveshafts (India) Ltd. (supra),* since the said procedure has been almost universally followed and has helped cut down litigation and crystallise the issues, if and when the question comes up before the Court.

10. Should time limit under section 263 to be reckoned with reference to the date of assessment order or the date of reassessment order, where the revision is in relation to an item which was not the subject matter of reassessment?

***I* Bombay High Court ruling in CIT v. Lark Chemicals Ltd (2014) 368 ITR 655**

Facts of the case: The assessee-company, for the assessment year 2002-03, filed its return of income declaring a total income of ` 30.98 lakhs. This was accepted and the return was processed under section 143(1). Subsequently, it was reopened by issue of notice under section 148 and the order of reassessment was passed in June, 2006. The Commissioner assumed jurisdiction for revision of order by invoking section 263 in March, 2009. The subject matter of revision, however, was not related to any of the issues dealt with in the reassessment.

Issue under consideration: The issue before the High Court was whether the revision under section 263 is barred by limitation in view of the fact that the issues dealt with therein were not the subject matter of reassessment.

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Tribunal's view: The Tribunal opined that jurisdiction under section 263 cannot be exercised in respect of those issues which were not the subject matter of consideration while passing the order of reassessment but were a part of the original assessment, the time limit for which had since expired. It relied on the Apex Court decision in the case of CIT v. Alagendran Finance Ltd. (2007) 293 ITR 1, wherein it was held that in such cases, the doctrine of merger would not apply and the period of limitation would commence from the date of original assessment and not from the date of reassessment.

High Court's Opinion: The High Court observed that if the revision happened to be in relation to issues dealt with in the reassessment proceedings, then, it would not be barred by limitation as the time limit would expire only on 31st March, 2009 i.e., two years from the end of the financial year in which the order sought to be revised under section 263, was passed. However, in this case, the revision proposed under section 263 was in respect of issues, other than the issues dealt with in the order of reassessment. The issues on which the Commissioner sought to exercise jurisdiction under section 263 were concluded by virtue of intimation issued under section 143(1). The time period for revision under section 263 is two years from the end of the financial year in which order sought to be revised was passed [i.e., two years from the end of the financial year in which the intimation was issued under section 143(1)] and that time period has expired long ago.

High Court's Decision: The High Court, thus, held that the jurisdiction under section 263 could not be assumed on issues which were not the subject matter of issues dealt with in the order of reassessment but were part of the original assessment, for which the period of limitation expired long ago.

II **Bombay High Court ruling in CIT v. ICICI Bank Ltd. (2012) 343 ITR 74**

Facts of the case: In the present case, an order of assessment was passed under section 143(3) allowing the deduction under section 36(1)(vii), 36(1)(viia) and foreign exchange rate difference. Further, two notices of reassessment were issued under section 148 and an order of reassessment was passed under section 147 which did not deal with the above deductions.

Later, the Commissioner passed an order under section 263 for disallowing the deduction under section 36(1)(vii), 36(1)(viia) and in respect of foreign exchange rate difference which have not been taken up in the reassessment proceedings under section 147 but which was decided in the original order of assessment passed under section 143(3).

Assessee's contention vis-à-vis Revenue's contention: The assessee claimed that the order passed by the Commissioner under section 263 is barred by limitation since the period of 2 years from the end of the financial year in which the order sought to be revised was passed, had lapsed. However, the Revenue gave a plea that period of limitation shall be reckoned from the date of order under section 147 and not from the date of the original assessment order under section 143(3), applying the doctrine of merger.

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The Revenue pointed out that as per the provisions of Explanation 3 to section 147, the Assessing Officer is entitled to assess or reassess the income in respect of any issue which has escaped assessment though the reasons in respect of such issue have not been included in the reasons recorded under section 148(2).

High Court's Decision: Considering the above mentioned facts, the Bombay High Court held that the order of assessment under section 143(3) allowed deduction under section 36(1)(vii), 36(1)(viia) and in respect of foreign exchange rate difference. The order of reassessment, however, had not dealt with these issues. Therefore, the doctrine of merger cannot be applied in this case. The order under section 143(3) cannot stand merged with the order of reassessment in respect of those issues which did not form the subject matter of the reassessment.

Therefore, the period of limitation in respect of the order of the Commissioner under section 263 with regard to a matter which does not form the subject matter of reassessment shall be reckoned from the date of the original order under section 143(3) and not from the date of the reassessment order under section 147.

11. Can the original assessment order under section 143(3), which was subsequently modified to give effect to the revision order under section 264, be later on subjected to revision under section 263?

CIT v. New Mangalore Port Trust (2016) 382 ITR 434 (Karn)

Facts of the case: The assessee-trust, a government undertaking carrying on commercial activities in one of the major ports was enjoying exemption under section 10(20) since its inception. On March 27, 2006, the assessee applied for registration under section 12A. However, the said application for registration was rejected by the Commissioner. On appeal before the Appellate Tribunal, the Commissioner was directed to grant registration under section 12AA to the assessee w.e.f. 1 April, 2003. To give effect to the order of the Tribunal, the Commissioner granted registration on July 27, 2009. Subsequent to the registration, an assessment order was passed by the Assessing Officer under section 143(3) on December 27, 2009. The assessee filed a revision petition under section 264 which was allowed and the matter was remanded to the Assessing Officer to compute the income of the assessee in terms of the order of revision under section 264. The Assessing Officer gave effect to the revision order vide order dated May 27, 2011. Thereafter, the original order passed under section 143(3), dated December 27, 2009 was revised by the Commissioner under section 263 on March 22, 2012.

The revision order under section 263 passed by Commissioner was challenged by the assessee before the Appellate Tribunal. The Tribunal set aside the revision order of the Commissioner passed under section 263.

Assessee's Contentions: The assessee contended before the High Court that the order passed by the Assessing Officer under section 143(3) on December 27, 2009 does not exist subsequent to the order of Commissioner passed under section 264, being given effect to by

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the Assessing Officer vide order dated May 27, 2011. The said order dated December 27, 2009 which no longer subsists, was revised by the Commissioner under section 263. In this case, invoking of suo motu revision powers by the Commissioner under section 263 is not justifiable.

High Court's Observations: The High Court took note of the sequence of events and undisputed facts that the assessment order dated 27 December 2009 passed by the Assessing Officer was no longer in existence. The High Court concluded that the Tribunal arrived at the conclusion only after considering the factual position that Commissioner had no jurisdiction to revise the order which was not in existence.

High Court's Decision: The High Court, accordingly, held that the order passed by the Commissioner under section 263, revising the non-existing order is void ab initio and is a nullity in the eyes of law

12. Can an assessee file a revision petition under section 264, if the revised return to correct an inadvertent error apparent from record in the original return, is filed after the time limit specified under section 139(5) on account of the error coming to the notice of the assessee after the specified time limit?

Sanchit Software and Solutions Pvt. Ltd. v. CIT (2012) 349 ITR 404 (Bom.)

Facts of the case: The assessee-company had electronically filed its return of income. It committed a mistake by including dividend income [exempt under section 10(34)] and long term capital gains on sale of shares [exempt under section 10(38)] in its return of income, though the same was correctly disclosed in the Schedule containing details of exempt income. The return was processed under section 143(1) denying the exemptions under section 10(38) and 10(34) and therefore, intimation under section 143(1) was served on the assessee raising a demand of tax. The assessee, on receiving the intimation, noticed the error committed and filed a revised return rectifying the error. However, the revised return was not sustainable as the same was filed beyond the period of limitation as provided under section 139(5). Later, the assessee filed an application for rectification under section 154 and also a revision petition under section 264.

Commissioner's contention: The Commissioner of income-tax, while considering the revision petition, contended that the intimation under section 143(1) was based on the return of the assessee, in which the claims under section 10(34) and under section 10(38) were not made by the assessee. Hence, it cannot be said that the intimation under section 143(1) was erroneous, since the same was squarely based on the return filed by the assessee. Secondly, the power of Commissioner under section 264 is only restricted to the record available before the Assessing Officer which can be examined by the Commissioner. In the circumstances, the other evidence sought to be brought on record to establish the mistake committed by the assessee cannot be considered by the Commissioner under section 264. The revision petition under section 264 was rejected by the Commissioner on the above grounds.

High Court's Observations: The High Court observed that the entire object of administration of tax is to secure the revenue for the development of the country and not to charge the assessee more tax than which is due and payable by the assessee. In this context, the High

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Court referred to the CBDT Circular issued as far back as 11th April, 1955 directing the Assessing Officer not to take advantage of the assessee's mistake. The High Court opined that the said Circular should always be borne in mind by the officers of the Revenue while administering the Act.

The High Court observed that, in this case, the Commissioner of income-tax had committed a fundamental error in proceeding on the basis that no deduction on account of dividend income and long-term capital gains under section 10 was claimed from the total income, without considering that the assessee had specifically sought to exclude the same as is evident from the entries in the relevant Schedule. Therefore, this was an error on the face of the order and hence, the same was not sustainable.

High Court's Decision: The High Court, accordingly, set aside the order of Commissioner and remanded the matter for fresh consideration.

The High Court further directed the Assessing Officer to consider the rectification application filed by the assessee under section 154 as a fresh application received on the date of service of this order and dispose of the rectification application on its own merits, without awaiting the result of the revision proceedings before the Commissioner of Income-tax on remand, at the earliest.

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EXERCISE

Question 1

X & Co Ltd. had made an application to the Settlement Commission. The issue in the said application related to cash credits in the books of account. The Commission passed an order making addition to the income on the basis of difference in gross profit rate adopted, which was neither an issue in the application nor in the report of the Commissioner of Income-tax. Discuss the validity of the order of the Settlement Commission.

Answer

The issue under consideration is whether the Settlement Commission can pass an order making addition to the income on the basis of difference in gross profit rate adopted, which was neither an issue in the application nor in the report of the Commissioner of Income-tax.

Section 245D(4) provides that the Settlement Commission, after examination of records and the report of the Commissioner and after examining such further evidence as may be placed before it or obtained by it, may, in accordance with the provisions of the Act, pass such order as it thinks fit.

Further, section 245D(5) provides that the materials brought on record before the Settlement Commission shall be considered by the Members of the concerned Bench before passing any order under section 245D(4).

"Consideration" means independent examination of the evidence and material brought on record before the Settlement Commission by the members and application of mind thereto with a view to independently assess the materials and evidence, whether adduced by the applicant or by the Commissioner, and come to a conclusion by themselves.

This view has been upheld in case of Supreme Agro Foods P Ltd. v. Income-tax Settlement Commission (2013) 353 ITR 385 (P&H)

The Settlement Commission, therefore, has to consider the material brought on record before it and "consideration" means independent examination of the evidence and material on record.

In this case, since the material was available before the Settlement Commission and such material has been taken into consideration for returning a finding which is relevant for determining the undisclosed income of the applicant, the addition made on the basis of difference in gross profit rate adopted is justified.

Therefore, the order of the Settlement Commission is valid.

Question 2

On an application made by Mr. Pandey, an order was passed by the Settlement Commission on 03-01-2018 under Section 245D(6B). The said order had a mistake apparent on record. The Settlement Commission suo-moto passed an amended order dated 30-07-2018 which resulted in modifying the liability of Mr. Pandey.

Mr. Pandey is of the view that order of the Settlement Commission is final and conclusive and it has no power to rectify the said mistake.

You are required to examine the following:

(i) Correctness of claim made by Mr. Pandey

(ii) Validity of the order amended by the Settlement Commission

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Answer

(i) Under section 245F(1), the Settlement Commission has been conferred all the powers which are vested in an income-tax authority under the Act. Under section 154, an income-tax authority has the power to amend any order passed by it in order to rectify any mistake apparent from the record. Therefore, the Settlement Commission's power to amend an order to rectify any mistake apparent from the record is embedded in section 245F(1).

Further, in order to reflect the correct intention of the legislature, section 245D(6B) specifically provides that the Settlement Commission may, at any time within a period of six months from the end of the month in which the order was passed, amend any order passed by it under section 245D(4) to rectify any mistake apparent from the record. In this case, the rectification order was passed by the Settlement Commission within six months from the end of the month in which the order was passed (i.e. by 31.7.2018)

Therefore, Mr. Pandey's view is not correct.

(ii) In this case, the rectification has the effect of modifying the liability of Mr. Pandey. Therefore, as per the second proviso to section 245D(6B), the Settlement Commission, before passing the amended order, should have –

(1) given a notice to the applicant and the Principal Commissioner/Commissioner of its intention to make such an amendment; and

(2) allowed the applicant and the Principal Commissioner/Commissioner an opportunity of being heard.

If these conditions are fulfilled, the order amended by the Settlement Commission would be a valid order, since the amended order is passed by the Settlement Commission within the permitted time limit i.e., within six months from the end of the month in which the original order was passed.

However, if the Settlement Commission has not given notice of its intention to make such an amendment or has not allowed the applicant and the Principal Commissioner/ Commissioner an opportunity of being heard, then, the amended order passed by it will not be valid.

Question 3

Seizures were made from Mr. Sunder pursuant to a search conducted in his premises. He filed an application for settlement by claiming to have received the amount by way of loans from several persons. The Settlement Commission accepted his statement and made an order. The CBI, however, conducted enquiry at the instance of the Revenue regarding the claimed amount of loans and opined that the alleged lenders had no means or financial capacity to advance such huge loans to Mr. Sunder and were mere name lenders only. The Commissioner filed an application under section 245D(6) praying for the order to be declared void and for withdrawal of benefit granted. Mr. Sunder, however, contended that the order of the Settlement Commission was final and any fresh analysis would amount to sitting in judgement over an earlier decision, for which the Settlement Commission was not empowered. Discuss the correctness of Mr. Sunder's contention.

Answer

The Apex Court, in CIT vs. Om Prakash Mittal (2005) 273 ITR 326, observed that a plain reading of section 245D(6) shows that every order passed under sub-section (4) has to provide for:-

(i) the terms of settlement; and

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(ii) that the settlement would become void, if it is subsequently found by the Settlement Commission that it has been obtained by fraud or misrepresentation of facts.

The decision that the order has been obtained by fraud or misrepresentation is that of the Settlement Commission. However, there is no requirement that the action be initiated by the Settlement Commission, suo moto. The Revenue can move the Settlement Commission for decision on an issue if it has material to show that the order was obtained by fraud or misrepresentation of facts.

The Supreme Court observed that the foundation for settlement is an application which an assessee can file at any stage of a case relating to him in such form and manner as may be prescribed. The fundamental requirement of the application under section 245C is that there must be full and true disclosure of the income along with the manner in which it has been derived. If an order is obtained by fraud or misrepresentation of facts, it cannot be said that there is a full and true disclosure and therefore, the Legislature has prescribed the condition relating to declaration of the order void when it is obtained by fraud or misrepresentation of facts.

The Supreme Court held that merely because section 245-I provides that the order of settlement is conclusive, it does not take away the power of the Settlement Commission to decide whether the settlement order has been obtained by fraud or misrepresentation of facts. If the Commissioner is able to establish that the earlier decision was void because of misrepresentation of facts, then it is open for the Settlement Commission to decide the issue. It cannot be called by any stretch of imagination to be a review of the earlier judgment or the subsequent Bench sitting in appeal over the earlier Bench's decision.

Mr. Sunder's contention is, therefore, not correct.

Question 4

Does the Settlement Commission have the power to reduce or waive interest levied under sections 234A, 234B and 234C of the Income-tax Act? Discuss.

Answer

The matter concerning the power of the Settlement Commission to reduce or waive interest chargeable under section 234A, 234B or 234C has been settled by the Supreme Court in CIT v. Anjum M.H.Ghaswala (2001) 252 ITR 1.

According to the judgment, the provisions of section 245D(6) are only procedural in nature providing for fixing the term by which the amounts settled under sub-section (4) will have to be paid. It does not empower the Commission either to reduce or waive the interest. Any settlement made by the Commission must be in accordance with the provisions of the Act.

The Settlement Commission does not have the power to reduce or waive the interest levied under sections 234A, 234B and 234C. It does not authorize the waiver or deduction of tax. The levy of interest under sections 234A, 234B or 234C is mandatory in nature and therefore any settlement made must include the interest under these sections. However, as per provisions of section 245F, the Settlement Commission shall have all the powers which are vested in an income-tax authority. Therefore, Settlement Commission can grant relief from the aforesaid interest to the extent of the powers given vide the circulars issued by CBDT under section 119.

Question 5

(a) Does the Settlement Commission have jurisdiction to entertain an application made under section 245C(1) in respect of a case covered by Chapter XIV-B (Search and seizure case).

(b) Discuss the power of the Settlement commission to grant immunity from prosecution and penalty.

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Answer

(a) Section 245A(b) defines the term `case' to mean any proceeding for assessment under the Act of any person in respect of any assessment year or years which is pending before the Assessing Officer on the date on which an application is made to the Settlement Commission.

Search cases are eligible for settlement through the Settlement Commission. Explanation to section 245A(b), provides that in case of a person referred to in section 153A or section 153C, a proceeding for assessment or reassessment shall be deemed to have been commenced on the date of issue of notice initiating such proceeding for assessment under section 153A or section 153C and concluded on the date on which the assessment is made. During this period, application for settlement of the case could be filed by the assessees.

Further, section 245C provides that an application before the settlement commission in cases falling under section 153A and 153C can be made, where the additional amount of income- tax payable on income disclosed in the application exceeds ` 50 lakh, in respect of the tax payer who is the subject matter of search and ` 10 lakh, in respect of entities related to such a tax payer, who are also the subject matter of search.

Moreover, 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.

(b) The power of Settlement Commission to grant immunity from prosecution and penalty is provided for in section 245H.

In respect of an application made on or after 1st June, 2007, the Settlement Commission's power to grant immunity from prosecution is restricted to offences under the Income-tax Act, 1961 and Wealth-tax Act, 1957. The Settlement Commission can also grant immunity from penalty imposed under the Income-tax Act, 1961. Such immunity from prosecution and penalty may be granted subject to conditions as it may think fit to impose.

However, the Settlement Commission may grant immunity only if the person who has made the application has co-operated with the Settlement Commission and made a full and true disclosure of his income and the manner in which it was derived. Further, the Settlement Commission while granting immunity to any person from prosecution shall record the reasons in writing in the order passed by it.

Also, the Settlement Commission cannot grant immunity if the prosecution proceeding for any such offence has been instituted before the date of receipt of application for settlement under section 245C.

Question 6

The business premises of Mr. Amit was subjected to a survey under section 133A of the Act. There were some incriminating materials found at the time of survey. The assessee apprehends reopening of assessments of the earlier years. He wants to know whether he can approach the Settlement Commission.

Explain briefly the basic conditions to be satisfied and the benefits that may accrue to Mr. Amit by approaching the Settlement Commission.

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Answer

An assessee may, at any stage of a case relating to him, make an application in the prescribed form and manner to the Settlement Commission under section 245C. "Case" means any proceeding for assessment which may be pending before an Assessing Officer on the date on which such application is made. Thus, the basic condition for making an application before the Settlement Commission under section 245C is that there must be a proceeding for assessment pending before an Assessing Officer on the date on which the application is made.

A proceeding for assessment or reassessment or recomputation under section 147 shall be deemed to have commenced from the date on which a notice under section 148 is issued.

In this case, Mr. Amit cannot approach the Settlement Commission merely due to his apprehension that assessment of earlier years may be reopened, since there is no case pending before an Assessing Officer.

Therefore, he has to wait for the Assessing Officer to issue notice under section 148. Thereafter, he can make an application to the Settlement Commission under section 245C, since there would be a "case pending" before the Assessing Officer on that date.

Another basic condition to be satisfied for making an application is that the additional amount of income-tax payable on the income disclosed in the application should exceed ` 10 lakh, and such tax and interest thereon which would have been paid had the income disclosed in the application been declared in the return of income should be paid on or before the date of making the application and proof of such payment should be attached with the application.

If the Settlement Commission is satisfied that Mr. Amit has co-operated in the proceedings and

made true and full disclosure of his income and the manner in which it has been derived, it may, subject to such conditions as it may think fit to impose, grant to Mr. Amit -

(i) immunity from prosecution for any offence under the Income-tax Act, 1961 / Wealth-tax Act, 1957, where the proceedings for such prosecution have been instituted on or after the date of receipt of application under section 245C; and

(ii) immunity from imposition of penalty under the Income-tax Act, 1961, either wholly or in part, with respect to the case covered by the settlement.

This is the benefit that may accrue to Mr. Amit, if he approaches the Settlement Commission.

Note: Where a notice under section 148 is issued for any assessment year, a proceeding under section 147 shall be deemed to have commenced on the date of issue of such notice and the assessee can approach the Settlement Commission for other assessment years as well, even if notice under section 148 for such other assessment years has not been issued but could have been issued on date. However, a return of income for such other assessment years should have been furnished under section 139 or the response to notice under section 142.

Question 7

Explain the powers of Settlement Commission to amend its order.

Answer

As per the section 245D(6B), the Settlement Commission may amend any order passed by it under section 245D(4) to rectify a mistake apparent from the record, within six months from the end of the month in which order was passed.

In case where an application for rectification is made by the Principal Commissioner or the

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Commissioner or the applicant within 6 months from the end of the month in which order under section 245D(4) was passed, the Settlement Commission may amend the order within six months from the end of the month in which an application for rectification has been made by the Principal Commissioner or Commissioner or the applicant.

However, an amendment which has the effect of modifying the liability of the applicant shall not be made unless the Settlement Commission –

(1) has given notice to the applicant and the Principal Commissioner or Commissioner of its intention to do so; and

(2) has allowed the applicant and the Principal Commissioner or Commissioner an opportunity of being heard.

Question 8

M/s. A Ltd. has received a notice under section 148 for the Assessment Year 2014-15 on 02-02-2018. They also anticipate similar notices for the Assessment Years 2012-13 and

2013-14 for which they have already furnished return of income. On examination of the books of account produced, you have noticed huge amounts of concealed income. As a consultant, what is your advice to A Ltd.?

Answer

As per section 245C, an assessee may, at any stage of a case relating to him, make an application in the prescribed form and manner to the Settlement Commission.

"Case" means any proceeding for assessment which may be pending before an Assessing Officer on the date on which such application is made.

A proceeding for assessment or reassessment or recomputation under section 147 is deemed to have commenced from the date of issue of notice under section 148. Where a notice under section 148 is issued for any assessment year, a proceeding under section 147 shall be deemed to have commenced on the date of issue of such notice and the assessee can approach the Settlement Commission for other assessment years as well, even if notice under section 148 for such other assessment years have not been issued but could have been issued on that date. However, a return of income for such other assessment years should have been furnished under section 139 or in response to notice under section 142.

In the case on hand, M/s A Ltd. has received a notice under section 148 for the A.Y.2014-15 and also anticipates similar notices for the A.Y.2012-13 and A.Y.2013-14, for which return of income has been furnished. Thus, a proceeding for assessment is pending before an Assessing Officer i.e., the basic condition for approaching Settlement Commission is satisfied.

Moreover, since after examination of the books of account, huge amount of concealed income is also noticed, it is presumed that the second condition that the additional amount of income-tax payable on the income disclosed in the application should exceed ` 10 lakhs has also been satisfied.

Based on these facts, assuming that the necessary conditions are fulfilled, our advice as consultant to M/s A Ltd. would be to approach the Settlement Commission to have his case settled and apply for grant of immunity from penalty and prosecution.

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Illustration 1

M/s. XYZ is a firm liable to tax@30%. The following are the particulars furnished by the firm for A.Y.2018-19:

	Particulars of total income	`
(1)	As per the return of income furnished u/s 139(1)	50,00,000
(2)	Determined under section 143(1)(a)	60,00,000
(3)	Assessed under section 143(3)	75,00,000
(4)	Reassessed under section 147	95,00,000

Can penalty be levied under section 270A on M/s. XYZ? If the answer is in the affirmative, compute the penalty leviable under section 270A.

Solution

M/s. XYZ is deemed to have under-reported its income since:

(1) its income assessed under 143(3) exceeds its income determined in a return processed under section 143(1)(a); and

(2) the income reassessed under section 147 exceeds the income assessed under section 143(3).

Therefore, penalty is leviable under section 270A for under-reporting of income.

Computation of penalty leviable under section 270A

Particulars	`	`
Assessment under section 143(3)		
Under-reported income:		
Total income assessed under section 143(3)	75,00,000	
(-) Total income determined u/s 143(1)(a)	60,00,000	
	15,00,000	
Tax payable on under-reported income:		
Tax on under-reported income of Rs. 15 lakhs plus tax on total income of Rs. 60 lakhs determined u/s 143(1)(a) **[30% of Rs.75 lakh + EC & SHEC@3%]**	23,17,500	
Less: Tax on total income determined u/s 143(1)(a) **[30% of Rs.60 lakh + EC & SHEC@3%]**	18,54,000	
	4,63,500	
Penalty leviable@50% of tax payable		2,31,750

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Reassessment under section 147		
Under-reported income:		
Total income reassessed under section 147	95,00,000	
(-) Total income assessed under section 143(3)	75,00,000	
	20,00,000	
Tax payable on under-reported income:		
Tax on under-reported income of Rs. 20 lakhs plus tax on total income of Rs. 75 lakhs assessed u/s 143(3) **[30% of Rs.95 lakh + EC & SHEC@3%]**	29,35,500	
Less: Tax on total income assessed u/s 143(3) **[30% of Rs.75 lakh + EC & SHEC@3%]**	23,17,500	
	6,18,000	
Penalty leviable@50% of tax payable		3,09,000

Note – The following assumptions have been made -

(1) None of the additions or disallowances made in assessment or reassessment qualifies under section 270A(6); and

(2) The under-reported income is not on account of misreporting.

Illustration 2

Mr. Ram, a resident individual of the age of 55 years, has not furnished his return of income for A.Y.2017-18. However, the total income assessed in respect of such year under section 143(3) is Rs.12 lakh. Is penalty under section 270A attracted in this case, and if so, what is the quantum of penalty leviable?

Solution

Mr. Ram is deemed to have under-reported his income since he has not filed his return of income and his assessed income exceeds the basic exemption limit of Rs. 2,50,000. Hence, penalty under section 270A is leviable in his case.

Computation of penalty leviable under section 270A

Particulars	`	`
Assessment under section 143(3)		
Under-reported income:		
Total income assessed under section 143(3)	12,00,000	
(-) Basic exemption limit	2,50,000	
	9,50,000	

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Tax payable on under-reported income as increased by the basic exemption limit [30% of Rs. 2 lakhs + Rs. 1,12,500]	1,72,500	
Add: EC & SHEC@3%	5,175	
	1,77,675	
Penalty leviable@50% of tax payable		88,838

Note – It is assumed that the under-reported income is not on account of misreporting.

Illustration 3

ABC Ltd. is a domestic company liable to tax@30%. The following are the particulars furnished by the company for A.Y.2018-19:

	Particulars of total income	`
(1)	As per the return of income furnished u/s 139(1)	(15,00,000)
(2)	Determined under section 143(1)(a)	(8,00,000)
(3)	Assessed under section 143(3)	(5,00,000)
(4)	Reassessed under section 147	4,00,000

Is penalty leviable under section 270A on ABC Ltd., and if so, what is the quantum of penalty?

Solution

ABC Ltd. is deemed to have under-reported its income since:

(1) the assessment under 143(3) has the effect of reducing the loss determined in a return processed under section 143(1)(a); and

(2) the reassessment under section 147 has the effect of converting the loss assessed under section 143(3) into income.

Therefore, penalty is leviable under section 270A for under-reporting of income.

Computation of penalty leviable under section 270A

Particulars	`	`
Assessment under section 143(3)		
Under-reported income:		
Loss assessed u/s 143(3)	(5,00,000)	
(-) Loss determined under section 143(1)(a)	(8,00,000)	
	3,00,000	
Tax payable on under-reported income@30%	90,000	
Add: EC & SHEC@3%	2,700	
	92,700	
Penalty leviable@50% of tax payable		46,350

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Reassessment under section 147		
Under-reported income:		
Total income reassessed under section 147	4,00,000	
(-) Loss assessed under section 143(3)	(5,00,000)	
	9,00,000	
Tax payable on under-reported income@30%	2,70,000	
Add: EC & SHEC@3%	8,100	
	2,78,100	
Penalty leviable@50% of tax payable		1,39,050

Note – The following assumptions have been made -

(1) None of the additions or disallowances made in assessment or reassessment qualifies under section 270A(6); and

(2) The under-reported income is not on account of misreporting.

Illustration 4

A private bank has not filed its statement of financial transaction or reportable account in relation to the specified financial transactions for the financial year 2016-17. A notice was issued by the prescribed income-tax authority on 1st October, 2017 requiring the bank to furnish the statement by 31st October, 2017. The bank, however, furnished the statement only on 15th November, 2017. 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)	Rs. 100 per day of continuing default	1.9.2017 to 31.10.2017	61 days × Rs. 100	6,100
285BA(5)	Rs. 500 per day of continuing default	1.11.2017 to 15.11.2017	15 days × Rs. 500	7,500
				13,600

EXERCISE

Question 1

A search under section 132 was initiated in the premises of Mr. X on 30.4.2017 and undisclosed money and jewellery belonging to Mr. X was found in his premises. Examine the penal provisions under the Income-tax Act which are attracted in this case, assuming that the undisclosed assets were

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acquired out of his undisclosed income of previous year 2017-18.

Answer

In order to deter the practice of non-disclosure of income, section 271AAB(1A) provides for levy of penalty on undisclosed income found during the course of a search, which relates to specified previous year, i.e.-

- 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 (P.Y. 2016-17);
- the previous year in which search is conducted (P.Y. 2017-18).

Accordingly, under section 271AAB(1A), in respect of searches initiated on or after 15.12.2016,

- penalty@30% 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, and furnishes the return of income for the specified previous year declaring such 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).
- In all other cases, penalty @60% of undisclosed income would be attracted.

Question 2

What is the quantum of penalty that could be levied in each of the following cases -

(i) Failure to get books of accounts audited as required under section 44AB within the time prescribed under the Act.

(ii) Failure to comply with a direction issued under section 142(2A).

(iii) Failure to furnish report from an accountant as required under section 92E.

Answer

The penalty that could be levied in each case is:

(i) Failure to get books of accounts audited as required under section 44AB of the Income-tax Act, 1961 - a sum equal to ½% of the total sales, turnover or gross receipts, as the case may be, in business, or of the gross receipts in profession, in such previous year or years, or a sum of Rs. 1,50,000, whichever is less [Section 271B].

(ii) Failure to comply with a direction issued under section 142(2A) – a sum of Rs. 10,000 [Section 272A(1)(d)].

(iii) Failure to furnish report from an accountant as required by section 92E - a sum of Rs. 1,00,000 [Section 271BA].

Question 3

X, an individual whose total sales in the business of food grains for the year ending 31.3.2018 was Rs. 205 lakhs, did not maintain books of account for P.Y.2017-18, even though his turnover exceeded Rs.10 lakhs in the P.Y.2016-17. The Assessing Officer levied penalty of Rs. 25,000 under section

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271A for non-maintenance of books of account and penalty of Rs. 1,02,500 under section 271B for not getting the books audited as required by section 44AB. Is the Assessing Officer justified in levying penalty under section 271B?

Answer

X is required to maintain books of account as per section 44AA for the P.Y.2017-18 since his turnover exceeded Rs.10 lakhs in the P.Y.2016-17. He also has to get them audited under section 44AB, since his gross sales in the P.Y.2017-18 exceeds Rs. 1 crore. He is liable to pay penalty under section
271A for not maintaining his books of account as per section 44AA. Accordingly, the action of the Assessing Officer in levying penalty of Rs. 25,000 under section 271A is correct. However, where books of account have not been maintained, there cannot be a question of getting them audited. Audit of books of account presupposes maintenance of books of account. When admittedly X has not maintained books, he cannot obviously get the audit done.

In Surajmal Parsuram Todi v. CIT (1996) 222 ITR 691, the Gauhati High Court has held that when a person commits an offence by not maintaining books of accounts as contemplated by section 44AA, the offence is complete and after that there can be no possibility of any offence as contemplated by section 44AB and, therefore, the imposition of penalty under section 271B is erroneous.

Therefore, in this case, the Assessing Officer is not justified in levying penalty under section 271B.

Question 4

State the conditions, if any, to be satisfied by an assessee in order to get relief under section 273A(4) regarding the waiver of penalty. Can the Commissioner refuse to grant relief, when the conditions laid down in the section was complied with, by the assessee?

Answer

There are two conditions to be satisfied by an assessee in order to get relief in the form of a waiver or reduction of penalty by the Commissioner of Income-tax under section 273A(4) of the Act. These conditions are:

(i) The payment of penalty would cause "genuine hardship" to the assessee and the Commissioner is satisfied about the existence of genuine hardship having regard to the circumstances of the case. The existence of genuine hardship would entitle the assessee to relief. The CBDT in its Circular No 784 dated 22-11-1999 has clarified that “genuine hardship” referred to in the provisions of section 273A(4) should exist both at the time at which the application under section 273A(4) is made by the assessee before the Commissioner and at the time of passing of order under section 273A(4) by the Commissioner.

(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.

As per the decision of Andhra Pradesh High Court in K.S.N. Murthy v. Chairman, CBDT (2001) 252 ITR 269, if the above two conditions are satisfied, the Commissioner has no discretion to refuse to exercise his powers. In case the quantum of penalty exceeds Rs. 1 lakh, the Commissioner can grant relief only with the previous approval of the Principal Chief Commissioner or Chief Commissioner or the Principal Director General or Director General, as the case may be.

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Note - The Principal Commissioner or Commissioner has to pass an order under section 273A(4), either accepting or rejecting the application in full or in part, within a period of 12 months from the end of the month in which the application is received. Further, no order rejecting the application, either in full or in part, shall be passed unless the assessee has been given an opportunity of being heard.

Question 5

An assessee had credited a sum of Rs.50,000 in cash in the account of Madan, said to represent a loan obtained from him. The Assessing Officer, having gone into the genuineness of the transaction, disbelieved the story of loan and treated the sum of Rs.50,000 as the income of the assessee from undisclosed sources. He also started proceedings under section 271D and levied a penalty of Rs.60,000 on the assessee for having accepted the loan in contravention of section 269SS. Examine the correctness of the levy.

Answer

There are several flaws in the penalty levied by the Assessing Officer. Firstly, the penalty leviable under section 271D cannot exceed the sum equal to the loan taken. Hence, the maximum penalty leviable would be Rs. 50,000. Secondly, any penalty imposable under section 271D shall be imposed by the Joint Commissioner. Hence, unless the Assessing Officer happens to be a Joint Commissioner the levy of penalty will be invalid. Thirdly, the Assessing Officer cannot, on the one hand, treat the loan as undisclosed income of the assessee and on the other, treat it as a loan for the purpose of section 269SS read with section 271D. Such a treatment will be self-contradictory. The moment the amount of Rs. 50,000 is treated as undisclosed income, it ceases to bear the character of loan and therefore, the foundation for the levy of penalty under section 271D disappears. [Diwan Enterprises v. CIT and Others (2000) 246 ITR 571].

Question 6

Examine the following cases and state whether the same are liable for penalty as per the provisions of the Income-tax Act, 1961.

(i) Raman & Associates had made payment in excess of the limits prescribed to the contractors for carrying out labour job work at various sites, but had not deducted tax at source as per section 194C.

(ii) Hotels and Hotels were asked by Income-tax Officer (CIB) to furnish details of all such tourists who stayed in their hotels and had paid bill amount in excess of Rs.10,000. They have not furnished the requisite information in spite of various reminders.

Answer

(i) Penalty under section 271C is attracted for failure to deduct tax at source. The penalty would be a sum equal to the amount of tax which such person has failed to deduct. Such penalty can be imposed only by the Joint Commissioner. Therefore, Raman & Associates shall be liable for penalty under section 271C equal to the amount of tax which they have failed to deduct under section 194C from the payments made to the contractors. The penalty would be in addition to the disallowance of 30% of expenditure/payment under section 40(a)(ia).

(ii) Section 133(6) empowers the Income-tax authority to require any person to furnish information in relation to such points or matters which will be useful for or relevant to any enquiry or

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proceeding under the Act. Failure on the part of an assessee to furnish the information in relation to such points or matters as required makes him liable for penalty under section 272A(2) of Rs. 100 for every day during which the failure continues.

Note – In a case where no proceeding is pending, the Income-tax authority can exercise this power only after obtaining the approval of the Principal Director/Director or Principal Commissioner/Commissioner as the case may be. In this case, it is presumed that the Income-tax authority has obtained the approval of the Principal Director/Director or Principal Commissioner/ Commissioner before exercising this power.

Question 7

Fox Limited failed to furnish information and documents sought by the Transfer Pricing Officer (TPO). Can TPO levy penalty for such failure? How much would be the quantum of penalty imposable for the said failure?

Answer

Under section 271G, if any person who has entered into an international transaction or specified domestic transaction fails to furnish any such information or document as required by section 92D(3) sought for by the Transfer Pricing Officer, then, such person shall be liable to a penalty which may be levied by the Assessing Officer or the Transfer Pricing Officer or the Commissioner (Appeals). Thus, the Transfer Pricing Officer is a competent authority to levy penalty.

Section 271G confers aforesaid power to the Transfer Pricing Officer for levy of penalty.

Penalty would be a sum equal to 2% of the value of international transaction or specified domestic transaction for each such failure.

Question 8

What would be the penalty leviable under section 270A in case of the following assessees, if none of the additions or disallowances made in the assessment or reassessment qualify under section 270A(6) and the under-reported income is not on account of misreporting?

	Particulars of total income of A.Y.2018-19	M/s. Alpha, a resident firm	Beta Ltd., an Indian company
		(`)	(`)
(1)	As per the return of income furnished u/s 139(1)	35,00,000	(12,00,000)
(2)	Determined under section 143(1)(a)	45,00,000	(6,00,000)
(3)	Assessed under section 143(3)	62,00,000	(2,00,000)
(4)	Reassessed under section 147	81,00,000	6,00,000

Note - The total turnover of Beta Ltd. for the P.Y.2015-16 was Rs.7 crore.

Answer

Penalty leviable under section 270A in case of M/s. Alpha, a resident firm

M/s. Alpha is deemed to have under-reported its income since:

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(1) its income assessed under 143(3) exceeds its income determined in a return processed under section 143(1)(a); and

(2) the income reassessed under section 147 exceeds the income assessed under section 143(3).

Therefore, penalty is leviable under section 270A for under-reporting of income.

Computation of penalty leviable under section 270A

Particulars	`	`
Assessment under section 143(3)		
Under-reported income:		
Total income assessed under section 143(3)	62,00,000	
(-) Total income determined u/s 143(1)(a)	45,00,000	
	17,00,000	
Tax payable on under-reported income:		
Tax on under-reported income of Rs. 17 lakhs plus total income of Rs. 45 lakhs determined u/s 143(1)(a) **[30% of Rs.62 lakh + EC & SHEC@3%]**	19,15,800	
Less: Tax on total income determined u/s 143(1)(a) **[30% of Rs.45 lakh + EC & SHEC@3%]**	13,90,500	
	5,25,300	
Penalty leviable@50% of tax payable		2,62,650
Reassessment under section 147		
Under-reported income:		
Total income reassessed under section 147	81,00,000	
(-) Total income assessed under section 143(3)	62,00,000	
	19,00,000	
Tax payable on under-reported income:		
Tax on under-reported income of Rs. 19 lakhs plus total income of ` 62 lakhs assessed u/s 143(3) **[30% of Rs.81 lakh + EC & SHEC@3%]**	25,02,900	
Less: Tax on total income assessed u/s 143(3) **[30% of Rs.62 lakh + EC & SHEC@3%]**	19,15,800	
	5,87,100	
Penalty leviable@50% of tax payable		2,93,550

Penalty leviable under section 270A in the case of Beta Ltd., an Indian company

Beta Ltd. is deemed to have under-reported its income since:

(1) the assessment under 143(3) has the effect of reducing the loss determined in a return processed under section 143(1)(a); and

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(2) the reassessment under section 147 has the effect of converting the loss assessed under section 143(3) into income.

Therefore, penalty is leviable under section 270A for under-reporting of income.

Computation of penalty leviable under section 270A

Particulars	`	`
Assessment under section 143(3)		
Under-reported income:		
Loss assessed u/s 143(3)	(2,00,000)	
(-) Loss determined under section 143(1)(a)	(6,00,000)	
	4,00,000	
Tax payable on under-reported income@30%	1,20,000	
Add: EC & SHEC@3%	3,600	
	1,23,600	
Penalty leviable@50% of tax payable		61,800
Reassessment under section 147		
Under-reported income:		
Total income reassessed under section 147	6,00,000	
(-) Loss assessed under section 143(3)	(2,00,000)	
	8,00,000	
Tax payable on under-reported income@30%	2,40,000	
Add: EC & SHEC@3%	7,200	
	2,47,200	
Penalty leviable@50% of tax payable		1,23,600

Note – The applicable rate of tax for Beta Ltd. for A.Y.2018-19 is 30%, since its turnover for the P.Y.2015-16 exceeded Rs. 5 crore.

SIGNIFICANT SELECT CASES

1. Is penalty under section 271D imposable for cash loans/deposits received from partners?

CIT v. Muthoot Financiers (2015) 371 ITR 408 (Del)

Facts of the case: The assessee-firm, engaged in business of banking and money lending, had received huge amounts from the partners in the assessment years 1996-97 and 1998-99 by way of cash. The Assessing Officer levied penalty under section 271D. The Commissioner (Appeals) upheld the levy of penalty. The Tribunal observed that the advance made to the firm by the partners cannot be regarded as loan accepted by the firm. It held that the amount advanced and accepted is capital of the firm and not loans which cannot be subjected to penalty under section 271D. The Revenue filed an appeal before High Court.

The assessee contended before the High Court that the amount advanced by the partners cannot be regarded as loan but is a capital of the firm. As the partnership firm has no separate legal entity, nor is there a separate identification between the firm and the partners, there is no violation

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of section 269SS in this case.

High Court's Opinion & Decision: The High Court referred to the case CIT v. R.M. Chidambaram Pillai (1977) 106 ITR 292, where the Apex Court was of the view that the firm is not a legal person even though it has some of the attributes of a personality. It held that the 'firm' is a collective noun, a compendious expression to designate an entity not a person. It also referred to CIT v. Sivakumar. V (2013) 354 ITR 9 (Mad), where the High Court upheld the conclusion of the Tribunal to hold that there is no separate legal entity for the partnership firm and the partner is entitled to use the funds of the firm. In CIT v. Lokhpat Film Exchange (Cinema) (2008) 304 ITR 172 (Raj), it was held that a partnership firm not being a juristic person, the inter se transaction between the firm and partners are not governed by the provisions of sections 269SS and 269T.

The High Court also noted the different view expressed by the Supreme Court in CIT v. A.W. Figgies & Co. (1953) 24 ITR 405, where it was held that the partners of the firm are distinct as civil entities while the firm as such is a separate and distinct unit for the purpose of assessment.

The High Court observed that the position that emerges is that there are three different Courts, which have held that section 269SS would not be violative when money is exchanged inter se between the partners and the firm.

The High Court further observed that, in this case, there was no dispute as regards the money brought in by the partners of the assessee-firm. The source of money was also not doubted. The transaction was bona fide and not aimed to avoid any tax liability. The credit worthiness of the partners and genuineness of the transactions coupled with relationship between the 'two persons' and two different legal interpretations put forward, could constitute a reasonable cause in a given case for not invoking sections 271D /271E read with section 273B.

The High Court held that the issue being a debatable one, there was reasonable cause for not levying penalty.

2. Can loan, exceeding the specified limit, advanced by a partnership firm to the sole-proprietorship concern of its partner be viewed as a violation of section 269SS to attract levy of penalty?

CIT v. V. Sivakumar (2013) 354 ITR 9 (Mad.)

Facts of the case: In the present case, the assessee was a partner in four firms and also had a sole-proprietary business. In the relevant previous year, the partnership firms had advanced loan to the assessee in cash exceeding the specified amount mentioned in section 269SS. The Assessing Officer initiated penalty proceedings under section 271D in view of violation of section 269SS. The Assessing Officer recorded a factual finding that the said money had been advanced by the partnership firm as a loan and were debited to the accounts of the proprietary concern; therefore, it was evident that the assessee had taken loan from the firms in cash in the capacity of the proprietor and not as a partner. Consequently, the provisions of section 269SS had been violated.

Assessee's contention: The assessee contended that the amount is taken in the capacity of the partner and it cannot be taken as an independent transaction and therefore, there is no violation of section 269SS. Also, the assessee contended that the partnership firm has no separate legal entity and there is no separate identification between the firm and the partner.

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Tribunal's view: The Tribunal, relying upon the various court decisions, confirmed the finding of the Commissioner (Appeals) that partnership firm is not a juristic person and there is no separate identity for the firm and the partners; Being a partner, the assessee had withdrawn amounts from the firms and there were no reasons to doubt the genuineness of the transactions. Consequently, the transactions between the firm and the partner cannot be brought within the meaning of section 269SS.

High Court's Decision: The High Court, relying upon the various court decisions, upheld the decision of the Tribunal holding that there is no separate identity for the partnership firm and that the partner is entitled to use the funds of the firm. In the present case, the assessee has acted *bona fide* and that there was a reasonable cause within the meaning of section 273B. Therefore, the transaction cannot be said to be in violation of section 269SS and no penalty is attracted in this case.

3. **Where an assessee repays a loan merely by passing adjustment entries in its books of account, can such repayment of loan by the assessee be taken as a contravention of the provisions of section 269T to attract penalty under section 271E?**

CIT v. Triumph International Finance (I.) Ltd. (2012) 345 ITR 270 (Bom.)

Facts of the case: In the present case, the assessee is a public limited company, registered as category-I merchant banker with SEBI, engaged in the business of stock broking, investment and trading in shares and securities. The assessee had taken a loan from the Investment Trust of India. During the previous year in question, the assessee had transferred shares of a company held by it to the Investment Trust of India. Therefore, in the current assessment year, the assessee was liable to pay the loan amount to the Investment Trust of India and had a right to receive the sale price of the shares transferred to Investment Trust of India. In order to avoid the unnecessary circular transfer of shares, both the parties agreed to set-off the amount payable and receivable by way of passing journal entries and the balance loan amount was paid by the assessee by way of an account payee cheque. The amount of loan settled by way of passing journal entries exceeds Rs. 20,000.

Assessing Officer's contentions: The Assessing Officer passed the assessment order levying penalty under section 271E for the contravention of the provisions of section 269T on the argument that since section 269T put an obligation on the assessee to pay loan only by way of an account payee cheque or an account payee draft, the settlement of a portion of the loan by passing journal entry would be a mode otherwise than by way of an account payee cheque or an account payee draft and therefore, the penal provisions under section 271E shall be attracted.

Assessee's contentions: The assessee argued that the transaction of repayment of loan or deposit by way of adjustment through book entries was carried out in the ordinary course of business and the genuineness of the assessee's transaction with the Investment Trust of India was also accepted by the Tribunal. It is a bonafide transaction. The assessee further contended that section 269T mentions that in a case where the loan or deposit is repaid by an outflow of funds, the same has to be by an account payee cheque or an account payee demand draft. However, in case the discharge of loan or deposit is in a manner otherwise than by an outflow

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of funds, as is the situation in the present case, the provisions of section 269T would not apply.

High Court's Observations: Considering the above mentioned facts and arguments, the Bombay High Court observed that, the obligation to repay the loan or deposit by account payee cheque/bank draft as specified in section 269T is mandatory in nature. The contravention of the said section will attract penalty under section 271E.

The argument of the assessee cannot be accepted since section 269T does not make a distinction between a bonafide or a non-bonafide transaction neither does it require the fulfillment of the condition mentioned therein only in case where there is outflow of funds. It merely puts a condition that in case a loan or deposit is repaid, it should be by way of an account payee cheque/draft. Therefore, in the present case the assessee has repaid a portion of loan in contravention of provisions of section 269T.

However, the cause shown by the assessee for repayment of the loan otherwise than by account payee cheque/bank draft was on account of the fact that the assessee was liable to receive amount towards the sale price of the shares sold by the assessee to the person from whom loan was received by the assessee. It would have been mere formality to repay the loan amount by account payee cheque/draft and receive back almost the same amount towards the sale price of the shares. Also, neither the genuineness of the receipt of loan nor the transaction of repayment of loan by way of adjustment through book entries carried out in the ordinary course of business has been doubted in the regular assessment. Therefore, there is nothing on record to suggest that the amounts advanced by Investment Trust of India to the assessee represented the unaccounted money of the Investment Trust of India or the assessee and also it cannot be said that the whole transaction was entered into to avoid tax. This is accepted as a reasonable cause under section 273B.

High Court's Decision: In effect, the assessee has violated the provisions of section 269T by repaying the loan amount by way of passing book entries and therefore, penalty under section 271E is applicable. However, since the transaction is bona fide in nature being a normal business transaction and has not been made with a view to avoid tax, it was held that the assessee has shown reasonable cause for the failure under section 269T, and therefore, as per the provisions of section 273B, no penalty under section 271E could be imposed on the assessee for contravening the provisions of section 269T.

Note: In order to mitigate the hardship caused by certain penalty provisions in case of genuine business transactions, section 273B provides that no penalty under, inter alia, section 271E shall be imposed on a person for any failure referred to in the said section, if such person proves that there was **reasonable cause** for such failure.

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Illustration 1

M/s. XYZ is a firm liable to tax@30%. The following are the particulars furnished by the firm for A.Y.2018-19:

	Particulars of total income	`
(1)	As per the return of income furnished u/s 139(1)	50,00,000
(2)	Determined under section 143(1)(a)	60,00,000
(3)	Assessed under section 143(3)	75,00,000
(4)	Reassessed under section 147	95,00,000

Can penalty be levied under section 270A on M/s. XYZ? If the answer is in the affirmative, compute the penalty leviable under section 270A.

Solution

M/s. XYZ is deemed to have under-reported its income since:

(1) its income assessed under 143(3) exceeds its income determined in a return processed under section 143(1)(a); and

(2) the income reassessed under section 147 exceeds the income assessed under section 143(3).

Therefore, penalty is leviable under section 270A for under-reporting of income.

Computation of penalty leviable under section 270A

Particulars	`	`
Assessment under section 143(3)		
Under-reported income:		
Total income assessed under section 143(3)	75,00,000	
(-) Total income determined u/s 143(1)(a)	60,00,000	
	15,00,000	
Tax payable on under-reported income:		
Tax on under-reported income of Rs. 15 lakhs plus tax on total income of Rs. 60 lakhs determined u/s 143(1)(a) **[30% of Rs.75 lakh + EC & SHEC@3%]**	23,17,500	
Less: Tax on total income determined u/s 143(1)(a) **[30% of Rs.60 lakh + EC & SHEC@3%]**	18,54,000	
	4,63,500	
Penalty leviable@50% of tax payable		2,31,750

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Reassessment under section 147		
Under-reported income:		
Total income reassessed under section 147	95,00,000	
(-) Total income assessed under section 143(3)	75,00,000	
	20,00,000	
Tax payable on under-reported income:		
Tax on under-reported income of Rs. 20 lakhs plus tax on total income of Rs. 75 lakhs assessed u/s 143(3) **[30% of Rs.95 lakh + EC & SHEC@3%]**	29,35,500	
Less: Tax on total income assessed u/s 143(3) **[30% of Rs.75 lakh + EC & SHEC@3%]**	23,17,500	
	6,18,000	
Penalty leviable@50% of tax payable		3,09,000

Note – The following assumptions have been made -

(1) None of the additions or disallowances made in assessment or reassessment qualifies under section 270A(6); and

(2) The under-reported income is not on account of misreporting.

Illustration 2

Mr. Ram, a resident individual of the age of 55 years, has not furnished his return of income for A.Y.2017-18. However, the total income assessed in respect of such year under section 143(3) is Rs.12 lakh. Is penalty under section 270A attracted in this case, and if so, what is the quantum of penalty leviable?

Solution

Mr. Ram is deemed to have under-reported his income since he has not filed his return of income and his assessed income exceeds the basic exemption limit of Rs. 2,50,000. Hence, penalty under section 270A is leviable in his case.

Computation of penalty leviable under section 270A

Particulars	`	`
Assessment under section 143(3)		
Under-reported income:		
Total income assessed under section 143(3)	12,00,000	
(-) Basic exemption limit	2,50,000	
	9,50,000	

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Tax payable on under-reported income as increased by the basic exemption limit [30% of Rs. 2 lakhs + Rs. 1,12,500]	1,72,500	
Add: EC & SHEC@3%	5,175	
	1,77,675	
Penalty leviable@50% of tax payable		88,838

Note – It is assumed that the under-reported income is not on account of misreporting.

Illustration 3

ABC Ltd. is a domestic company liable to tax@30%. The following are the particulars furnished by the company for A.Y.2018-19:

	Particulars of total income	`
(1)	As per the return of income furnished u/s 139(1)	(15,00,000)
(2)	Determined under section 143(1)(a)	(8,00,000)
(3)	Assessed under section 143(3)	(5,00,000)
(4)	Reassessed under section 147	4,00,000

Is penalty leviable under section 270A on ABC Ltd., and if so, what is the quantum of penalty?

Solution

ABC Ltd. is deemed to have under-reported its income since:

(1) the assessment under 143(3) has the effect of reducing the loss determined in a return processed under section 143(1)(a); and

(2) the reassessment under section 147 has the effect of converting the loss assessed under section 143(3) into income.

Therefore, penalty is leviable under section 270A for under-reporting of income.

Computation of penalty leviable under section 270A

Particulars	`	`
Assessment under section 143(3)		
Under-reported income:		
Loss assessed u/s 143(3)	(5,00,000)	
(-) Loss determined under section 143(1)(a)	(8,00,000)	
	3,00,000	
Tax payable on under-reported income@30%	90,000	
Add: EC & SHEC@3%	2,700	
	92,700	
Penalty leviable@50% of tax payable		46,350

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DT QUESTION BANK BY YNB

Reassessment under section 147		
Under-reported income:		
Total income reassessed under section 147	4,00,000	
(-) Loss assessed under section 143(3)	(5,00,000)	
	9,00,000	
Tax payable on under-reported income@30%	2,70,000	
Add: EC & SHEC@3%	8,100	
	2,78,100	
Penalty leviable@50% of tax payable		1,39,050

Note – The following assumptions have been made -

(1) None of the additions or disallowances made in assessment or reassessment qualifies under section 270A(6); and

(2) The under-reported income is not on account of misreporting.

Illustration 4

A private bank has not filed its statement of financial transaction or reportable account in relation to the specified financial transactions for the financial year 2016-17. A notice was issued by the prescribed income-tax authority on 1st October, 2017 requiring the bank to furnish the statement by 31st October, 2017. The bank, however, furnished the statement only on 15th November, 2017. 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)	Rs. 100 per day of continuing default	1.9.2017 to 31.10.2017	61 days × Rs. 100	6,100
285BA(5)	Rs. 500 per day of continuing default	1.11.2017 to 15.11.2017	15 days × Rs. 500	7,500
				13,600

EXERCISE

Question 1

A search under section 132 was initiated in the premises of Mr. X on 30.4.2017 and undisclosed money and jewellery belonging to Mr. X was found in his premises. Examine the penal provisions under the Income-tax Act which are attracted in this case, assuming that the undisclosed assets were

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acquired out of his undisclosed income of previous year 2017-18.

Answer

In order to deter the practice of non-disclosure of income, section 271AAB(1A) provides for levy of penalty on undisclosed income found during the course of a search, which relates to specified previous year, i.e.-

- 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 (P.Y. 2016-17);
- the previous year in which search is conducted (P.Y. 2017-18).

Accordingly, under section 271AAB(1A), in respect of searches initiated on or after 15.12.2016,

- penalty@30% 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, and furnishes the return of income for the specified previous year declaring such 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).
- In all other cases, penalty @60% of undisclosed income would be attracted.

Question 2

What is the quantum of penalty that could be levied in each of the following cases -

(i) Failure to get books of accounts audited as required under section 44AB within the time prescribed under the Act.

(ii) Failure to comply with a direction issued under section 142(2A).

(iii) Failure to furnish report from an accountant as required under section 92E.

Answer

The penalty that could be levied in each case is:

(i) Failure to get books of accounts audited as required under section 44AB of the Income-tax Act, 1961 - a sum equal to ½% of the total sales, turnover or gross receipts, as the case may be, in business, or of the gross receipts in profession, in such previous year or years, or a sum of Rs. 1,50,000, whichever is less [Section 271B].

(ii) Failure to comply with a direction issued under section 142(2A) – a sum of Rs. 10,000 [Section 272A(1)(d)].

(iii) Failure to furnish report from an accountant as required by section 92E - a sum of Rs. 1,00,000 [Section 271BA].

Question 3

X, an individual whose total sales in the business of food grains for the year ending 31.3.2018 was Rs. 205 lakhs, did not maintain books of account for P.Y.2017-18, even though his turnover exceeded Rs.10 lakhs in the P.Y.2016-17. The Assessing Officer levied penalty of Rs. 25,000 under section

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271A for non-maintenance of books of account and penalty of Rs. 1,02,500 under section 271B for not getting the books audited as required by section 44AB. Is the Assessing Officer justified in levying penalty under section 271B?

Answer

X is required to maintain books of account as per section 44AA for the P.Y.2017-18 since his turnover exceeded Rs.10 lakhs in the P.Y.2016-17. He also has to get them audited under section 44AB, since his gross sales in the P.Y.2017-18 exceeds Rs. 1 crore. He is liable to pay penalty under section
271A for not maintaining his books of account as per section 44AA. Accordingly, the action of the Assessing Officer in levying penalty of Rs. 25,000 under section 271A is correct. However, where books of account have not been maintained, there cannot be a question of getting them audited. Audit of books of account presupposes maintenance of books of account. When admittedly X has not maintained books, he cannot obviously get the audit done.

In Surajmal Parsuram Todi v. CIT (1996) 222 ITR 691, the Gauhati High Court has held that when a person commits an offence by not maintaining books of accounts as contemplated by section 44AA, the offence is complete and after that there can be no possibility of any offence as contemplated by section 44AB and, therefore, the imposition of penalty under section 271B is erroneous.

Therefore, in this case, the Assessing Officer is not justified in levying penalty under section 271B.

Question 4

State the conditions, if any, to be satisfied by an assessee in order to get relief under section 273A(4) regarding the waiver of penalty. Can the Commissioner refuse to grant relief, when the conditions laid down in the section was complied with, by the assessee?

Answer

There are two conditions to be satisfied by an assessee in order to get relief in the form of a waiver or reduction of penalty by the Commissioner of Income-tax under section 273A(4) of the Act. These conditions are:

(i) The payment of penalty would cause "genuine hardship" to the assessee and the Commissioner is satisfied about the existence of genuine hardship having regard to the circumstances of the case. The existence of genuine hardship would entitle the assessee to relief. The CBDT in its Circular No 784 dated 22-11-1999 has clarified that “genuine hardship” referred to in the provisions of section 273A(4) should exist both at the time at which the application under section 273A(4) is made by the assessee before the Commissioner and at the time of passing of order under section 273A(4) by the Commissioner.

(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.

As per the decision of Andhra Pradesh High Court in K.S.N. Murthy v. Chairman, CBDT (2001) 252 ITR 269, if the above two conditions are satisfied, the Commissioner has no discretion to refuse to exercise his powers. In case the quantum of penalty exceeds Rs. 1 lakh, the Commissioner can grant relief only with the previous approval of the Principal Chief Commissioner or Chief Commissioner or the Principal Director General or Director General, as the case may be.

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Note - The Principal Commissioner or Commissioner has to pass an order under section 273A(4), either accepting or rejecting the application in full or in part, within a period of 12 months from the end of the month in which the application is received. Further, no order rejecting the application, either in full or in part, shall be passed unless the assessee has been given an opportunity of being heard.

Question 5

An assessee had credited a sum of Rs.50,000 in cash in the account of Madan, said to represent a loan obtained from him. The Assessing Officer, having gone into the genuineness of the transaction, disbelieved the story of loan and treated the sum of Rs.50,000 as the income of the assessee from undisclosed sources. He also started proceedings under section 271D and levied a penalty of Rs.60,000 on the assessee for having accepted the loan in contravention of section 269SS. Examine the correctness of the levy.

Answer

There are several flaws in the penalty levied by the Assessing Officer. Firstly, the penalty leviable under section 271D cannot exceed the sum equal to the loan taken. Hence, the maximum penalty leviable would be Rs. 50,000. Secondly, any penalty imposable under section 271D shall be imposed by the Joint Commissioner. Hence, unless the Assessing Officer happens to be a Joint Commissioner the levy of penalty will be invalid. Thirdly, the Assessing Officer cannot, on the one hand, treat the loan as undisclosed income of the assessee and on the other, treat it as a loan for the purpose of section 269SS read with section 271D. Such a treatment will be self-contradictory. The moment the amount of Rs. 50,000 is treated as undisclosed income, it ceases to bear the character of loan and therefore, the foundation for the levy of penalty under section 271D disappears. [Diwan Enterprises v. CIT and Others (2000) 246 ITR 571].

Question 6

Examine the following cases and state whether the same are liable for penalty as per the provisions of the Income-tax Act, 1961.

(i) Raman & Associates had made payment in excess of the limits prescribed to the contractors for carrying out labour job work at various sites, but had not deducted tax at source as per section 194C.

(ii) Hotels and Hotels were asked by Income-tax Officer (CIB) to furnish details of all such tourists who stayed in their hotels and had paid bill amount in excess of Rs.10,000. They have not furnished the requisite information in spite of various reminders.

Answer

(i) Penalty under section 271C is attracted for failure to deduct tax at source. The penalty would be a sum equal to the amount of tax which such person has failed to deduct. Such penalty can be imposed only by the Joint Commissioner. Therefore, Raman & Associates shall be liable for penalty under section 271C equal to the amount of tax which they have failed to deduct under section 194C from the payments made to the contractors. The penalty would be in addition to the disallowance of 30% of expenditure/payment under section 40(a)(ia).

(ii) Section 133(6) empowers the Income-tax authority to require any person to furnish information in relation to such points or matters which will be useful for or relevant to any enquiry or

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proceeding under the Act. Failure on the part of an assessee to furnish the information in relation to such points or matters as required makes him liable for penalty under section 272A(2) of Rs. 100 for every day during which the failure continues.

Note – In a case where no proceeding is pending, the Income-tax authority can exercise this power only after obtaining the approval of the Principal Director/Director or Principal Commissioner/Commissioner as the case may be. In this case, it is presumed that the Income-tax authority has obtained the approval of the Principal Director/Director or Principal Commissioner/ Commissioner before exercising this power.

Question 7

Fox Limited failed to furnish information and documents sought by the Transfer Pricing Officer (TPO). Can TPO levy penalty for such failure? How much would be the quantum of penalty imposable for the said failure?

Answer

Under section 271G, if any person who has entered into an international transaction or specified domestic transaction fails to furnish any such information or document as required by section 92D(3) sought for by the Transfer Pricing Officer, then, such person shall be liable to a penalty which may be levied by the Assessing Officer or the Transfer Pricing Officer or the Commissioner (Appeals). Thus, the Transfer Pricing Officer is a competent authority to levy penalty.

Section 271G confers aforesaid power to the Transfer Pricing Officer for levy of penalty.

Penalty would be a sum equal to 2% of the value of international transaction or specified domestic transaction for each such failure.

Question 8

What would be the penalty leviable under section 270A in case of the following assessees, if none of the additions or disallowances made in the assessment or reassessment qualify under section 270A(6) and the under-reported income is not on account of misreporting?

	Particulars of total income of A.Y.2018-19	M/s. Alpha, a resident firm	Beta Ltd., an Indian company
		(`)	(`)
(1)	As per the return of income furnished u/s 139(1)	35,00,000	(12,00,000)
(2)	Determined under section 143(1)(a)	45,00,000	(6,00,000)
(3)	Assessed under section 143(3)	62,00,000	(2,00,000)
(4)	Reassessed under section 147	81,00,000	6,00,000

Note - The total turnover of Beta Ltd. for the P.Y.2015-16 was Rs.7 crore.

Answer

Penalty leviable under section 270A in case of M/s. Alpha, a resident firm

M/s. Alpha is deemed to have under-reported its income since:

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(1) its income assessed under 143(3) exceeds its income determined in a return processed under section 143(1)(a); and

(2) the income reassessed under section 147 exceeds the income assessed under section 143(3).

Therefore, penalty is leviable under section 270A for under-reporting of income.

Computation of penalty leviable under section 270A

Particulars	`	`
Assessment under section 143(3)		
Under-reported income:		
Total income assessed under section 143(3)	62,00,000	
(-) Total income determined u/s 143(1)(a)	45,00,000	
	17,00,000	
Tax payable on under-reported income:		
Tax on under-reported income of Rs. 17 lakhs plus total income of Rs. 45 lakhs determined u/s 143(1)(a) **[30% of Rs.62 lakh + EC & SHEC@3%]**	19,15,800	
Less: Tax on total income determined u/s 143(1)(a) **[30% of Rs.45 lakh + EC & SHEC@3%]**	13,90,500	
	5,25,300	
Penalty leviable@50% of tax payable		2,62,650
Reassessment under section 147		
Under-reported income:		
Total income reassessed under section 147	81,00,000	
(-) Total income assessed under section 143(3)	62,00,000	
	19,00,000	
Tax payable on under-reported income:		
Tax on under-reported income of Rs. 19 lakhs plus total income of ` 62 lakhs assessed u/s 143(3) **[30% of Rs.81 lakh + EC & SHEC@3%]**	25,02,900	
Less: Tax on total income assessed u/s 143(3) **[30% of Rs.62 lakh + EC & SHEC@3%]**	19,15,800	
	5,87,100	
Penalty leviable@50% of tax payable		2,93,550

Penalty leviable under section 270A in the case of Beta Ltd., an Indian company

Beta Ltd. is deemed to have under-reported its income since:

(1) the assessment under 143(3) has the effect of reducing the loss determined in a return processed under section 143(1)(a); and

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(2) the reassessment under section 147 has the effect of converting the loss assessed under section 143(3) into income.

Therefore, penalty is leviable under section 270A for under-reporting of income.

Computation of penalty leviable under section 270A

Particulars	`	`
Assessment under section 143(3)		
Under-reported income:		
Loss assessed u/s 143(3)	(2,00,000)	
(-) Loss determined under section 143(1)(a)	(6,00,000)	
	4,00,000	
Tax payable on under-reported income@30%	1,20,000	
Add: EC & SHEC@3%	3,600	
	1,23,600	
Penalty leviable@50% of tax payable		61,800
Reassessment under section 147		
Under-reported income:		
Total income reassessed under section 147	6,00,000	
(-) Loss assessed under section 143(3)	(2,00,000)	
	8,00,000	
Tax payable on under-reported income@30%	2,40,000	
Add: EC & SHEC@3%	7,200	
	2,47,200	
Penalty leviable@50% of tax payable		1,23,600

Note – The applicable rate of tax for Beta Ltd. for A.Y.2018-19 is 30%, since its turnover for the P.Y.2015-16 exceeded Rs. 5 crore.

SIGNIFICANT SELECT CASES

1. Is penalty under section 271D imposable for cash loans/deposits received from partners?

CIT v. Muthoot Financiers (2015) 371 ITR 408 (Del)

Facts of the case: The assessee-firm, engaged in business of banking and money lending, had received huge amounts from the partners in the assessment years 1996-97 and 1998-99 by way of cash. The Assessing Officer levied penalty under section 271D. The Commissioner (Appeals) upheld the levy of penalty. The Tribunal observed that the advance made to the firm by the partners cannot be regarded as loan accepted by the firm. It held that the amount advanced and accepted is capital of the firm and not loans which cannot be subjected to penalty under section 271D. The Revenue filed an appeal before High Court.

The assessee contended before the High Court that the amount advanced by the partners cannot be regarded as loan but is a capital of the firm. As the partnership firm has no separate legal entity, nor is there a separate identification between the firm and the partners, there is no violation

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of section 269SS in this case.

High Court's Opinion & Decision: The High Court referred to the case CIT v. R.M. Chidambaram Pillai (1977) 106 ITR 292, where the Apex Court was of the view that the firm is not a legal person even though it has some of the attributes of a personality. It held that the 'firm' is a collective noun, a compendious expression to designate an entity not a person. It also referred to CIT v. Sivakumar. V (2013) 354 ITR 9 (Mad), where the High Court upheld the conclusion of the Tribunal to hold that there is no separate legal entity for the partnership firm and the partner is entitled to use the funds of the firm. In CIT v. Lokhpat Film Exchange (Cinema) (2008) 304 ITR 172 (Raj), it was held that a partnership firm not being a juristic person, the inter se transaction between the firm and partners are not governed by the provisions of sections 269SS and 269T.

The High Court also noted the different view expressed by the Supreme Court in CIT v. A.W. Figgies & Co. (1953) 24 ITR 405, where it was held that the partners of the firm are distinct as civil entities while the firm as such is a separate and distinct unit for the purpose of assessment.

The High Court observed that the position that emerges is that there are three different Courts, which have held that section 269SS would not be violative when money is exchanged inter se between the partners and the firm.

The High Court further observed that, in this case, there was no dispute as regards the money brought in by the partners of the assessee-firm. The source of money was also not doubted. The transaction was bona fide and not aimed to avoid any tax liability. The credit worthiness of the partners and genuineness of the transactions coupled with relationship between the 'two persons' and two different legal interpretations put forward, could constitute a reasonable cause in a given case for not invoking sections 271D /271E read with section 273B.

The High Court held that the issue being a debatable one, there was reasonable cause for not levying penalty.

2. Can loan, exceeding the specified limit, advanced by a partnership firm to the sole-proprietorship concern of its partner be viewed as a violation of section 269SS to attract levy of penalty?

CIT v. V. Sivakumar (2013) 354 ITR 9 (Mad.)

Facts of the case: In the present case, the assessee was a partner in four firms and also had a sole-proprietary business. In the relevant previous year, the partnership firms had advanced loan to the assessee in cash exceeding the specified amount mentioned in section 269SS. The Assessing Officer initiated penalty proceedings under section 271D in view of violation of section 269SS. The Assessing Officer recorded a factual finding that the said money had been advanced by the partnership firm as a loan and were debited to the accounts of the proprietary concern; therefore, it was evident that the assessee had taken loan from the firms in cash in the capacity of the proprietor and not as a partner. Consequently, the provisions of section 269SS had been violated.

Assessee's contention: The assessee contended that the amount is taken in the capacity of the partner and it cannot be taken as an independent transaction and therefore, there is no violation of section 269SS. Also, the assessee contended that the partnership firm has no separate legal entity and there is no separate identification between the firm and the partner.

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Tribunal's view: The Tribunal, relying upon the various court decisions, confirmed the finding of the Commissioner (Appeals) that partnership firm is not a juristic person and there is no separate identity for the firm and the partners; Being a partner, the assessee had withdrawn amounts from the firms and there were no reasons to doubt the genuineness of the transactions. Consequently, the transactions between the firm and the partner cannot be brought within the meaning of section 269SS.

High Court's Decision: The High Court, relying upon the various court decisions, upheld the decision of the Tribunal holding that there is no separate identity for the partnership firm and that the partner is entitled to use the funds of the firm. In the present case, the assessee has acted *bona fide* and that there was a reasonable cause within the meaning of section 273B. Therefore, the transaction cannot be said to be in violation of section 269SS and no penalty is attracted in this case.

3. **Where an assessee repays a loan merely by passing adjustment entries in its books of account, can such repayment of loan by the assessee be taken as a contravention of the provisions of section 269T to attract penalty under section 271E?**

CIT v. Triumph International Finance (I.) Ltd. (2012) 345 ITR 270 (Bom.)

Facts of the case: In the present case, the assessee is a public limited company, registered as category-I merchant banker with SEBI, engaged in the business of stock broking, investment and trading in shares and securities. The assessee had taken a loan from the Investment Trust of India. During the previous year in question, the assessee had transferred shares of a company held by it to the Investment Trust of India. Therefore, in the current assessment year, the assessee was liable to pay the loan amount to the Investment Trust of India and had a right to receive the sale price of the shares transferred to Investment Trust of India. In order to avoid the unnecessary circular transfer of shares, both the parties agreed to set-off the amount payable and receivable by way of passing journal entries and the balance loan amount was paid by the assessee by way of an account payee cheque. The amount of loan settled by way of passing journal entries exceeds Rs. 20,000.

Assessing Officer's contentions: The Assessing Officer passed the assessment order levying penalty under section 271E for the contravention of the provisions of section 269T on the argument that since section 269T put an obligation on the assessee to pay loan only by way of an account payee cheque or an account payee draft, the settlement of a portion of the loan by passing journal entry would be a mode otherwise than by way of an account payee cheque or an account payee draft and therefore, the penal provisions under section 271E shall be attracted.

Assessee's contentions: The assessee argued that the transaction of repayment of loan or deposit by way of adjustment through book entries was carried out in the ordinary course of business and the genuineness of the assessee's transaction with the Investment Trust of India was also accepted by the Tribunal. It is a bonafide transaction. The assessee further contended that section 269T mentions that in a case where the loan or deposit is repaid by an outflow of funds, the same has to be by an account payee cheque or an account payee demand draft. However, in case the discharge of loan or deposit is in a manner otherwise than by an outflow

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of funds, as is the situation in the present case, the provisions of section 269T would not apply.

High Court's Observations: Considering the above mentioned facts and arguments, the Bombay High Court observed that, the obligation to repay the loan or deposit by account payee cheque/bank draft as specified in section 269T is mandatory in nature. The contravention of the said section will attract penalty under section 271E.

The argument of the assessee cannot be accepted since section 269T does not make a distinction between a bonafide or a non-bonafide transaction neither does it require the fulfillment of the condition mentioned therein only in case where there is outflow of funds. It merely puts a condition that in case a loan or deposit is repaid, it should be by way of an account payee cheque/draft. Therefore, in the present case the assessee has repaid a portion of loan in contravention of provisions of section 269T.

However, the cause shown by the assessee for repayment of the loan otherwise than by account payee cheque/bank draft was on account of the fact that the assessee was liable to receive amount towards the sale price of the shares sold by the assessee to the person from whom loan was received by the assessee. It would have been mere formality to repay the loan amount by account payee cheque/draft and receive back almost the same amount towards the sale price of the shares. Also, neither the genuineness of the receipt of loan nor the transaction of repayment of loan by way of adjustment through book entries carried out in the ordinary course of business has been doubted in the regular assessment. Therefore, there is nothing on record to suggest that the amounts advanced by Investment Trust of India to the assessee represented the unaccounted money of the Investment Trust of India or the assessee and also it cannot be said that the whole transaction was entered into to avoid tax. This is accepted as a reasonable cause under section 273B.

High Court's Decision: In effect, the assessee has violated the provisions of section 269T by repaying the loan amount by way of passing book entries and therefore, penalty under section 271E is applicable. However, since the transaction is bona fide in nature being a normal business transaction and has not been made with a view to avoid tax, it was held that the assessee has shown reasonable cause for the failure under section 269T, and therefore, as per the provisions of section 273B, no penalty under section 271E could be imposed on the assessee for contravening the provisions of section 269T.

Note: In order to mitigate the hardship caused by certain penalty provisions in case of genuine business transactions, section 273B provides that no penalty under, inter alia, section 271E shall be imposed on a person for any failure referred to in the said section, if such person proves that there was **reasonable cause** for such failure.

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OFFENCES

Section	Nature of default	Rigorous imprisonment	Quantum of 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 **(+) fine**	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 **(+) fine**	No limit specified
276	Removal, concealment, transfer or delivery of property to thwart tax recovery	Upto 2 years **(+) fine**	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 sections 178(1) and (3).	6 months to 2 years	-
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	-
276B	Failure to pay to the Central Government, tax deducted under the provisions of Chapter XVII-B or the tax payable by him, as required by (i) section 115-O(2); or (ii) Second proviso to section 194B	3 months to 7 years **(+) fine**	No limit specified
276BB	Failure to pay to the Central Government tax collected under section 206C	3 months to 7 years **(+) fine**	No limit specified
276C(1)	Wilful attempt to evade tax, penalty or interest chargeable or imposable or under	Evaded tax/Tax on under reported	No limit specified
	reports his income	income exceeding 25 lakh: 6 months to 7 years **(+) fine** Other cases : 3 months to 2 years **(+) fine**	
276C(2)	Wilful attempt to evade payment of tax, penalty or interest.	3 months to 2 years **(+) fine, at the discretion of the court.**	No limit specified

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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 **(+) fine** Other cases: 3 months to 2 years **(+) fine**	No limit specified
276D	Willful failure to produce accounts and documents under section 142(1)/ 142(2A)	Up to one year **(+) fine**	No limit specified
277	False statements in verification.	Evaded tax exceeding 25 lakh: 6 months to 7 years **(+) fine** In other cases: 3 months to 2 years **(+) fine**	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 **(+) fine**	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**(+) fine** In other cases: 3 months to 2 years **(+) fine**	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**(+) fine**	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**(+) fine**	No limit specified

EXERCISE

Question 1

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OFFENCES

Can prosecution be launched for each of the following actions or defaults committed? If yes, then explain the relevant provisions of the Act and the quantum of prescribed punishment.

(i) The assessee had restrained and not allowed the officer authorized as per section 132(1)(iib) of the Act to inspect the documents maintained in the form of electronic record and the books of accounts.

(ii) The assessee deliberately has failed to comply with the requirement of section 142(1) and/or 142(2A).

(iii) The assessee deliberately has failed to make the payment of the tax collected under section 206C.

Answer

(i) Failure to afford facility to the officer authorized as per section 132(1)(iib) is a case for which **prosecution can be launched under section 275B** and such person shall be punishable with rigorous imprisonment **for a term which may extend to two years and shall also be liable to fine.**

(ii) Willful failure to produce books of account and documents as required under section 142(1) or willful failure to comply with a direction to get the accounts audited under section 142(2A) is a case for which **prosecution can be launched under section 276D** and such person shall be **punishable with rigorous imprisonment for a term which may extend to one year and with fine.**

(iii) Deliberate failure to deposit the tax collected under section 206C to the credit of the Central Government is a case for which **prosecution can be launched under section 276BB** and such person shall be **punishable with rigorous imprisonment for a term which shall not be less than three months but which may extend to seven years and with fine.**

Question 2

The Assessing Officer lodged a complaint against M/s. KLM, a firm, under section 276CC of the Income-tax Act, 1961 for failure to furnish its return of income for the A.Y.2015-16 within the due date under section 139(1). The tax payable on the assessed income, as reduced by the advance tax paid and tax deducted at source, was ` 60,000. The appeal filed by the firm against the order of assessment was allowed by the Commissioner (Appeals). The Assessing Officer passed an order giving effect to the order of the Commissioner (Appeals). The tax payable by the firm as per the said order of the Assessing Officer was ` 1,000. The Assessing Officer has accepted the order of the Commissioner (Appeals) and has not preferred an appeal against it to the Income Tax Appellate Tribunal. The firm desires to know of the maintainability of the prosecution proceedings in the facts and circumstances of the case.

Answer

Section 276CC provides for prosecution for wilful failure to furnish a return of income within the prescribed time, in a case where tax would have been evaded had the failure not been discovered. Since the amount of tax which would have been evaded does not exceed ` 25 lakh, the imprisonment would be for a term of 3 months to 2 years. In addition, fine would also be attracted.

However, in a case where the return of income is not filed within the due date, prosecution proceedings will not be attracted if the tax payable by the assessee on the total income determined on regular assessment, as reduced by the advance tax, if any, paid and any tax deducted at source, does not exceed ` 3,000.

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In this case, even though the tax liability of the firm as per the original order of assessment exceeded ` 3,000, however, as a result of the order of the Commissioner (Appeals), it got reduced to ` 1,000, which is less than ` 3,000. Therefore, since the tax liability of the firm on final assessment was determined at ` 1,000, the prosecution proceedings are not maintainable.

In Guru Nanak Enterprises v. ITO (2005) 279 ITR 30, where the facts were similar, the Supreme Court held that prosecution was unwarranted.

Question 3

Explain section 278C applicable in respect of offences committed by Hindu undivided families.

Answer

As per section 278C(1) of the Income-tax Act, 1961, where an offence under the Income-tax Act, 1961 has been committed by a Hindu undivided family (HUF), the karta shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly. However, the karta shall not be liable to any punishment if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence.

As per section 278C(2), where an offence under the Income-tax Act, 1961 has been committed by a HUF and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of any member of the HUF, such member shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

Question 4

Can the Department launch prosecution in a case where they have accepted the revised return filed by the assessee, rectifying a mistake in the original return of income?

Answer

This question came up before the Karnataka High Court in K.E. Sunil Babu, Asst. CIT v. Steel Processors (2006) 286 ITR 315**.** The High Court observed that since the Department had accepted the revised returns filed under section 139(5), it was clear that there was a bona fide mistake in the original return and there was no element of mens rea. Therefore, the High Court held that the Department cannot launch prosecution under sections 276C, 277 and 278.

SIGNIFICANT SELECT CASES

1. Would prosecution proceedings under section 276CC be attracted where the failure to furnish return in time was not willful?

Union of India v. Bhavecha Machinery and Others (2010) 320 ITR 263 (MP)

High Court's Observation and Decision: In this case, the High Court observed that for the provisions of section 276CC to get attracted, there should be a willful delay in filing return and not merely a failure to file return in time. There should be clear, cogent and reliable evidence that the failure to file return in time was 'willful' and there should be no possible doubt of its being 'wilful'. The failure must be intentional, deliberate, calculated and conscious with complete knowledge of legal consequences flowing from them.

In this case, it was observed that there were sufficient grounds for delay in filing the return of income and such delay was not willful. Therefore, prosecution proceedings under section 276CC are not attracted in such a case.

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Question 1

"NEPTUNE" is a shipliner, used in carrying passengers and cargo, owned by M/s Thomas & Thomas of U.K. The ship carried the passengers and cargo in June, 2016 from Singapore to Chennai and vice versa and collected charges thereof amounting to ` 200 lacs. It left Chennai port on 15.6.2016 for its journey to Korea. No other journey to India was undertaken by any of the vessels of the company during the year ended on 31.3.2017. The non-resident company had authorized its Indian agent to comply with the income tax provisions.

You are consulted by the company to explain about the procedure as to return of income to be filed and the period within which the assessment thereof will be completed by the Assessing Officer.

Answer

M/s. Thomas & Thomas of U.K shall be required to file the return of income in India for the journey of its ship before it leaves for onward journey to Korea.

However, as per the proviso to section 172(3), where the Assessing Officer is satisfied that it is not possible for the master of the ship to furnish the return before the departure of the ship from the port, and if satisfactory arrangements have been made for filing of return and payment of tax by the authorised agent in India, he may permit filing of return within 30 days of departure of the ship.

Section 172(4A) provides a time limit of 9 months for completion of assessment in such cases. The period of 9 months is reckoned from the end of the financial year in which the return under section 172(3) is furnished.

Question 2

The directors of a private company are personally liable to pay the income tax due from the company but their liability does not extend towards interest and penalty payable by the company. Discuss.

Answer

Section 179 contains the provisions relating to the liability of directors of a private company in liquidation in respect of tax due from the company. Where any tax due from a private company in respect of income of any previous year or from any other company in respect of any income of any previous year during which such other company was a private company cannot be recovered, then, every person who was a director of such company at any time during the relevant previous year shall be jointly and severally liable for the payment of such tax. However, the director shall not be so liable if 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.

Explanation to section 179 clarifies that the expression **"tax due" includes penalty, interest or any other sum payable under the Act.** Therefore, the directors liability is not confined to tax alone but extends to penalty, interest or any other sum payable by the company

Question 3

In respect of the taxes due from a private limited company, which could not be recovered from it, the Tax Recovery Officer attached the properties of an erstwhile director for recovery thereof. It was contended by the director that a notice under section 156 had not been served on him and therefore, the proceedings for recovery were not valid. What is the correct legal position?

Answer

The liability of a director of a private limited company for arrears due from the company is provided in section 179. There is no necessity to issue a notice to a director, because the position of a person on whom liability is fastened is equated to that of an 'assessee' in default. For the purpose

of section 220(4), the person held liable under section 179 would be deemed to be an assessee-in-default. This may be contrasted with the arrears of a partnership firm which may be recovered from the erstwhile partners only after issue of a notice under section 156 and a default is committed by them.

Under section 179, every person who was a director of a private limited company at any time during the relevant previous year shall be jointly and severally liable for the payment of taxes which cannot be recovered from the company, unless he proves that the non-recovery cannot be attributed to any gross negligence, misfeasance or breach of duty on his part in relation to the affairs of the company.

EXERCISE

Question 1

How does the income of a person who is trying to alienate his assets with a view to avoid tax be dealt with under the Act?

Answer

The income of a person who is trying to alienate his assets with a view to avoid tax will be dealt with as per the provisions of section 175.

Accordingly, if it appears to the Assessing Officer during any current assessment year that any person is likely to charge, sell, transfer, dispose of or otherwise part with any of his assets with a view to avoiding payment of any liability under the Income-tax Act, 1961, 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.

The total income of each completed year or part of any previous year included in such period shall be chargeable to tax at the rates in force in that assessment year and separate assessments will be made for each completed previous year or part of any previous year.

The Assessing Officer may estimate the income of such individual for such period or any part thereof, where it cannot be readily determined in the manner provided in the Act.

The tax chargeable under this section shall be in addition to tax, if any, chargeable under any other provision of the Act.

Question 2

Fearless General Finance & Investment Limited, a residuary non-banking company, accepts public deposits, issues deposit certificate and repays the same after some period of time along with interest, under different schemes run by it. Following transactions were noted from their books of account:

(i) Mr. A, an individual, has deposited Rs.15,000 on 1st May, 2014 for 48 months by bearer cheque and another Rs.15,000 on 30th June, 2017 in cash to purchase a new certificate of 48 months tenure.

(ii) Mr. A has applied for premature withdrawal against both the certificates and the company has paid him Rs.16,500, by a bearer cheque, against principal and interest on 23rd March, 2018, due against his first certificate (purchased in 2014) and Rs. 15,500 in cash on 25th March, 2018, against the second certificate.

Discuss the violation of income tax provision, if any, and consequential penalty for each transaction. Will it make any difference if the certificates were held by Mr. A with his wife Mrs. A, jointly, while repaying back in cash or bearer cheque?

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Answer

(i) There is no violation of section 269SS at the time of acceptance of the first deposit of Rs. 15,000 by bearer cheque on 1.5.2014, since it is not in excess of the threshold limit of Rs. 20,000. However, violation under section 269SS is attracted at the time of acceptance of the second deposit in cash on 30th June, 2017, since as on that date, there is already an outstanding deposit of Rs. 15,000 and another cash deposit of Rs. 15,000 would take the aggregate to Rs. 30,000, which exceeds the threshold limit of Rs. 20,000. Therefore, penalty under section 271D of a sum equal to the amount of deposit taken from Mr. A is attracted for failure to comply with the provisions of section 269SS.

(ii) In this case, there is a violation of the provisions of section 269T at the time of first repayment by bearer cheque on 23rd March, 2018, since on that date, the aggregate amount of deposits held by Mr. A with the non-banking company (together with interest payable on such deposits) is more than Rs. 20,000. Therefore, penalty under section 271E equal to the amount of deposit so repaid will be attracted for failure to comply with the provisions of section 269T.

However, the second repayment of Rs. 15,500 on 25th March, 2018 in cash cannot be considered as a violation of section 269T, since neither the amount of deposit with interest thereon nor the aggregate amount of deposits held by Mr. A on that date together with interest exceeds the threshold limit of Rs. 20,000.

The provisions of section 269T will be attracted at the time of first repayment of bearer cheque even if the certificate is being held by Mr. A in joint name with his wife.

Question 3

The proceedings before the Income-tax Authorities either can be attended by the assessee in person or through an authorized representative. Who can be treated as an authorized representative of the assessee?

Answer

As per section 288, the proceedings before the income-tax authorities can be attended by an assessee in person or through an authorised representative, i.e., a person authorized by the assessee in writing to appear on his behalf, being -

(i) a person who is a relative or a regular employee of the assessee; or

(ii) any officer of a Scheduled Bank in which the assessee maintains a current account or has other regular dealings; or

(iii) a legal practitioner who is entitled to practise in any civil court in India; or

(iv) a chartered accountant within the meaning of the Chartered Accountants Act, 1949 who hold a valid certificate of practice

(v) any person who has passed any accountancy examination recognized in this behalf by the CBDT for this purpose; or

(vi) any person who has acquired such educational qualifications as prescribed by the CBDT; or

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(vii) any person who, before the coming into force of this Act in the Union territory of Dadra and Nagar Haveli, Goa, Daman and Diu, or Pondicherry, attended any proceedings before an income-tax authority in the said territory on behalf of any assessee otherwise than in the capacity of an employee or relative of that assessee

(viii) any person who was actually practising as an income-tax practitioner, immediately before commencement of the Income-tax Act, 1961.

Question 4

An order for A.Y. 2016-17 was passed by the Assessing Officer as per section 143(3), but the typist wrongly typed in the order, the assessment year as A.Y.2015-16 and the relevant previous year as ending on 31.3.2015. The assessee claimed in appeal that the same is an invalid order which was not accepted by the CIT (Appeals) on the ground of the error being of clerical nature. Discuss the correctness of the order of the CIT(Appeals).

Answer

Section 292B provides that no return of income, assessment, notice or summons furnished or made or issued or taken in pursuance of any of the provisions of the Income-tax Act, 1961 shall be invalid or deemed to be invalid merely by reason of any mistake, defect or omission in such return of income, assessment or notice etc., if such return of income, assessment, notice, summons etc. is in substance and effect in conformity with or according to the intent and purpose of the Act. **Therefore, a clerical mistake cannot invalidate an otherwise valid assessment.** Thus, the typographical error in the assessment order as to assessment year and previous year does not make the same invalid unless established otherwise. Accordingly, the action of the CIT(Appeals) in not accepting the claim of the assessee is valid.

Question 5

"Proceedings cannot be initiated under the Act, unless a proper notice to this effect has been served upon." In this context answer:

(i) What are the prescribed modes of service of such notice?

(ii) On whom should the notice be addressed and served upon in the cases where the assessee is a dissolved firm, a deceased person and a partitioned HUF.

Answer

(i) As per section 282(1), 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 of documents as may be provided by rules made by

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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.

(ii) The service of notice in the given cases should be on the persons mentioned hereunder:-

Person	Notice to be addressed and served on
A dissolved firm	Any person who was a partner (not being a minor) immediately before dissolution.
A deceased person	The legal heirs of the deceased.
A partitioned HUF	Last Manager of the HUF, or, if he is dead, then, all adult members of the erstwhile HUF.

Question 6

"Tax Recovery Officer, can recover the arrear demands from the assessee in default out of sale proceeds of the property attached after making a proclamation". How can such proclamation be made under the Act?

Answer

Movable Property [Rules 38 & 39 of Schedule II to the Income-tax Act, 1961]

Where the Tax Recovery Officer orders sale of movable property, he should issue a proclamation in the language of the district, of the intended sale, specifying the time and place of sale and whether the sale is subject to confirmation or not.

The proclamation should be made by beat of drum or other customary mode, -

(a) in the case of property attached by actual seizure –

  (i) in the village in which the property was seized, or, if the property was seized in a town or city, then, in the locality in which it was seized; and

  (ii) at such other places as the Tax Recovery Officer may direct;

(b) in the case of property attached otherwise than by actual seizure, in such places, if any, as the Tax Recovery Officer may direct.

A copy of the proclamation should also be affixed in a conspicuous part of the office of the Tax Recovery Officer.

Immovable Property [Rule 54 of Schedule II to the Income-tax Act, 1961]

The Tax Recovery Officer shall make a proclamation for sale of immovable property at some place on or near such property by beat of drum or other customary mode. A copy of the proclamation shall be affixed on a conspicuous part of the property and also upon a conspicuous part of the office of the Tax Recovery Officer.

Where the Tax Recovery Officer directs, such proclamation shall also be published in the Official Gazette or in a local newspaper or in both, and the cost of such publication shall be deemed to be cost of the sale.

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Where the property to be sold is divided into lots for the purpose of being sold separately, then it is not necessary to make a separate proclamation for each lot of property, unless in the opinion of the Tax Recovery Officer, proper notice of sale cannot otherwise be given.

Question 7

Explain the circumstances under which the Assessing Officer can resort to provisional attachment of the property of the assessee. Also, state the period of time for which such attachment can take place.

When can the Assessing Officer revoke provisional assessment of property? Discuss.

Answer

As per the provisions of section 281B, there can be provisional attachment to protect the interest of Revenue in certain cases i.e.-

(i) The proceeding for the assessment of any income or for the assessment or reassessment of any income which has escaped assessment should be pending.

(ii) Such attachment should be necessary for the purpose of protecting the interest of Revenue in the opinion of the Assessing Officer.

(iii) The previous approval of the Principal Chief Commissioner or Chief Commissioner, Principal Commissioner or Commissioner, Principal Director General or Director General or Principal Director or Director has been obtained by the Assessing Officer.

(iv) The Assessing Officer, may, by an order in writing attach provisionally any property belonging to the assessee in the manner provided in the Second Schedule.

(v) Such provisional attachment shall cease to have effect after the expiry of a period of six months from the date of order made under section 281B(1). However, the period can be extended by the Principal Chief Commissioner or Chief Commissioner, Principal commissioner or Commissioner, Principal Director General or Director General or Principal Director or Director, as the case may be, for the reasons to be recorded in writing for a further period or periods as he thinks fit. The total period of extension in any case cannot exceed 2 years or 60 days after the date of order of assessment or reassessment, whichever is later.

The Assessing Officer shall, by order in writing, revoke provisional attachment of a property made under section 281B(1) in a case where the assesse furnishes a guarantee from a scheduled bank, for an amount not less than the fair market value of such provisionally attached property or for an amount which is sufficient to protect the interests of the revenue.

Question 8

Mr. Biswas, a stock broker, has defaulted with regard to his income-tax payments and the Assessing Officer has attached his membership card of Stock Exchange under section 281B of the Income-tax Act, 1961. Mr. Biswas contends that the membership card is not transferable and is not his personal asset. Discuss the validity of attachment of the card by the Assessing Officer in the context of Section 281B.

Answer

The right of membership is not a private asset and it is merely a personal privilege granted to the

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member. It is non-transferable and incapable of alienation by the member or his legal representative except to the limited extent provided in the rules and regulations of the stock exchange and subject to the fulfillment of conditions prescribed by the stock exchange. The nomination, even if permitted, is subject to the rules and is not automatic. The right of nomination is vested in the stock exchange absolutely in the case of death of or default of a member. Thus, the membership card is not the property of the assessee and therefore cannot be attached under section 281B. It has been so held by the Apex Court in the case of Stock Exchange Ahmedabad vs. ACIT (2001) 248 ITR 209.

SIGNIFICANT SELECT CASES

Can the Assessing Officer suo moto assume jurisdiction to declare sale of property as void under section 281?

Dr. ManojKabra v. ITO (2014) 364 ITR 541 (All)

Facts of the case: The assessee acquired a property for Rs. 7 lakhs though the stamp duty was paid in accordance with the circle rate which was Rs. 12 lakhs. Pursuant to the sale deed, the assessee took possession of the property. Prior to the sale, the income tax assessment of vendor had been completed and a certain demand was raised against him in respect of the assessment year when the sale of the property was effected. The Assessing Officer issued a notice under section 281 to show cause as to why the sale deed executed in his favour (assessee-buyer) should not be treated as a void document. The assessee-buyer contended that he was a bona fide purchaser for adequate consideration and no notice of pendency of proceedings was to known him nor was it brought to his knowledge by the seller.

The assessee placed reliance on the decision of Supreme Court in the case of TRO v. Gangadhar Vishwanath Ranade (Decd.) (1998) 234 ITR 188, where it was held that section 281 of the Income-tax Act, 1961 is only a declaratory provision and not an adjudicatory provision entitling the income-tax authority to declare a document as a void document.

High Court's Observation: The High Court observed that the issue in this case was squarely covered by above Apex Court decision which held that the legislature had no intention to confer any exclusive power or jurisdiction upon the income-tax authority to decide any question arising under section 281. The Income-tax Act, 1961, does not prescribe any adjudicatory machinery for deciding any question which may arise under section 281. In order to declare a transfer as fraudulent under section 281, an appropriate proceeding in accordance with law was required to be taken under section 53 of the Transfer of Property Act, 1882. The Assessing Officer is required to file a suit for declaration to the effect that the transaction of transfer was void under section 281 of the Income-tax Act; but he himself cannot assume jurisdiction to declare the sale deed as void.

High Court's Decision: Applying the rationale of the Apex Court ruling, the High Court held that the Assessing Officer has no jurisdiction under section 281 to *suo moto* declare the sale as void.

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Illustration 1

Sea Port Shipping Line, a non-resident foreign company operating its ships on the Indian Ports during the previous year ended on 31.3.2018, had collected freight of Rs.100 lakhs, demurrages of Rs.20 lakhs and handling charges of Rs.10 lakhs. The expenses of operating its fleet during the year for the Indian Ports were Rs.110 lakhs. The company denies its liability to tax in India. Examine.

Solution

The provisions of section 44B would be beneficial in this case. This section provides that in the case of an assessee, being a non-resident, engaged in the business of operation of ships, a sum equal to 7.5% of the aggregate of the following amounts would be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession".

(i) The amount paid or payable, whether within India or outside, to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods shipped at any port in India; and

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

The above amounts will include demurrage charges and handling charges.

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

Therefore, in this case, M/s. Sea Port Shipping Line is required to pay tax in India on the basis of presumptive tax scheme as per the provisions of section 44B. The assessee shall not be entitled to set off any of the expenses incurred for earning of such income. Therefore, the Shipping Line is required to pay tax on deemed profit of Rs.9.75 lacs (7.50% on the total receipts of Rs.130 lacs).

(2) Special provision for computing profits and gains in connection with the business of exploration etc. of mineral oils [Section 44BB]

Illustration 2

Mr. Q, a non-resident, operates an aircraft between Singapore and Chennai. He received the following amounts while carrying on the business of operation of aircrafts for the year ended 31.3.2018:

(i) Rs.2 crores in India on account of carriage of passengers from Chennai.

(ii) Rs.1 crore in India on account of carriage of goods from Chennai.

(iii) Rs.3 crores in India on account of carriage of passengers from Singapore.

(iv) Rs.1 crore in Singapore on account of carriage of passengers from Chennai.

The total expenditure incurred by Mr. Q for the purposes of the business during the year ending 31.3.2018 was Rs.6.75 Crores.

Compute the income of Mr. Q chargeable to tax in India under the head "Profits and gains of business or profession" for the assessment year 2018-19.

What would be your answer in case the business was carried on by a foreign company, Q Airlines (P) Ltd?

Solution

Section 44BBA says for computing profits and gains of the business of operation of aircraft in the case of non-residents a sum equal to 5% of the aggregate of the following amounts -

(a) 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) received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods from any place outside India.

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

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

Income from business under section 44BBA at 5% of Rs.7,00,00,000 is Rs.35,00,000, which is the income of Mr. Q chargeable to tax in India under the head "Profits and gains of business or profession" for the A.Y. 2018-19.

In case the assessee is a foreign company, say, Q Airlines (P) Ltd, the answer would be the same since section 44BBA does not distinguish corporate and non-corporate taxpayers who operate aircraft provided their residential status is that of non-resident.

(4) 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]

Illustration 3

The net result of the business carried on by a branch of foreign company in India for the year ended 31.03.2018 was a loss of Rs.100 lakhs after charge of head office expenses of Rs.200 lakhs allocated to the branch. Explain with reasons the income to be declared by the branch in its return for the assessment year 2018-19.

Solution

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

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

The amount of income to be declared by the assessee for A.Y. 2018-19 will be as under:

Particulars	`
Net loss for the year ended on 31.03.2018	(100 lakhs)
Add: Amount of head office expenses to be considered separately as per section 44C	200 lakhs
Adjusted total income	100 lakhs
Less: Head Office expenses allowable under section 44C is the lower of (i) ` 5 Lakhs, being 5% of ` 100 Lakhs, or (ii) ` 200 Lakhs.	5 lakhs
Income to be declared in return	**95 lakhs**

(6) Special provision for computing income by way of royalties etc. in case of non-residents [Section 44DA]

Illustration 4

Mr. A, a non-resident Indian remits US $ 40,000 to India on 16.09.2001. The amount is partly utilised on 3.10.2001 for purchasing 10,000 shares in A Ltd an Indian Company at the rate of Rs.12 per share. These shares are sold for Rs.48 per share on 30.03.2018.

The telegraphic transfer buying and selling rate of US dollars adopted by the State Bank of India is as follows :-

Date	*Buying Rate (1 US$)*	*Selling Rate (1 US $)*
16.09.2001	*18*	*20*
3.10.2001	*19*	*21*
30.3.2018	*59*	*61*

Compute Capital gain chargeable to tax for the AY 2018-19 on the assumption that –

(a) These shares have not been sold through a recognised stock exchange

(b) These shares have been sold through a recognised stock exchange and securities transaction tax of Rs.704 was paid by Mr. A.

Solution

(a) Where the shares are not sold through recognised stock exchange

Particulars	US $
Sale consideration (` 4,80,000/60)	8000
Less: Cost of Acquisition (1,20,000/20)	6000
Long term Capital Gain	**2000**

Long-term capital gain converted into $ 2000 x Rs.59) = Rs.1,18,000

(b) **Where the shares are sold through a recognised stock exchange:** The entire long-term capital gain shall be exempt as per section 10(38), assuming that the other conditions mentioned thereunder are satisfied.

Illustration 5

A non-resident Indian acquired shares on 1.1.2008 for Rs.1,00,000 in foreign currency. These shares are sold by him on 1.1.2017 for Rs.3,00,000. He invests Rs.3,00,000 in shares on 31.03.2017 and these shares are sold by him on 30.06.2017 for Rs. 3,50,000. Discuss the tax implications. Ignore the effect of first proviso to section 48.

Solution

Computation of Long term Capital Gain for Assessment Year 2017-18

Particulars	Amount (`)
Sale consideration	3,00,000
Less: Cost of Acquisition	1,00,000
Long Term Capital Gain	2,00,000
Less: Exemption under section 115F	2,00,000
Exempt Long-term Capital Gain	**NIL**

Long Term Capital Gain for Assessment year 2018-19:

1. LTCG of Rs.2,00,000 which was exempt in A.Y.2017-18 becomes taxable this year.
2. STCG of Rs.50,000 is also taxable this year.

Illustration 6

Mr. John, a non-resident Indian, purchased shares of an Indian Company at a cost of Rs.70,000 on 01.07.2009 in foreign currency. Mr. John sold the said shares for a consideration of Rs.2,50,000 on 01.08.2017 and the expenditure incurred wholly or exclusively in connection with the transfer is Rs.10,000. Compute the taxable capital gain if he deposited in specified assets Rs.1,50,000 out of sale consideration. Ignore the effect of first proviso to section 48.

Solution

Particulars	Amount (`)
Sale Consideration	2,50,000
Less: Transfer Expenses	10,000
Net Consideration	2,40,000
Less: Cost of Acquisition	70,000
Long-term capital gain	1,70,000
Less: Exemption u/s 115F	1,06,250*
Taxable long-term capital gain	**63,750**

* $\frac{1,70,000 \times 1,50,000}{2,40,000}$ = 1,06,250

Illustration 7

During the financial year 2017-18, Nadal, a tennis professional and a non-Indian citizen participated in India in a Tennis Tournament and won the prize money of Rs.15 lacs. He contributed articles on the tournament in a local newspaper for which he was paid Rs.1 Lac. He was also paid Rs.5,00,000 by a Soft Drink company for appearance in a T.V. advertisement. Although his expenses in India were met by the sponsors, he had to incur Rs.3,00,000 towards his travel costs to India. He was a non-resident for tax purposes in India.

What would be his tax liability in India for A.Y. 2018-19? Is he required to file his return of income?

Solution

Under section 115BBA, all the three items of receipts in India viz. prize money of Rs.15 lakhs, amount received from newspaper of Rs.1 lakh and amount received towards TV advertisement of Rs.5 lakhs - are chargeable to tax. No expenditure is allowable against such receipts. The rate of tax chargeable under section 115BBA is 20%, plus education cess @2% and secondary and higher education cess @1%. The total tax liability works out to Rs.4,32,600 being 20.6% of Rs.21 lakhs. Thus, Nadal will be liable to tax on the income earned in India

He is not required to file his return of income if - 572

(a) his total income during the previous year consists only of income arising under section 115BBA; **and**

(b) the tax deductible at source under the provisions of Chapter XVII-B have been deducted from such incomes.

Illustration 8

Smith, a foreign national and a cricketer came to India as a member of Australian cricket team in the year ended 31st March, 2018. He received Rs.5 lakhs for participation in matches in India. He also received Rs.1 lakh for an advertisement of a product on TV. He contributed articles in a newspaper for which he received Rs.10,000. When he stayed in India, he also won a prize of Rs.20,000 from horse racing in Mumbai. He has no other income in India during the year.

(i) Compute tax liability of Smith for Assessment Year 2018-19.

(ii) Are the income specified above subject to deduction of tax at source?

(iii) Is he liable to file his return of income for Assessment Year 2018-19?

(iv) What would have been his tax liability, had he been a match referee instead of a cricketer?

Solution

(i) Computation of tax liability of Smith for the A.Y.2018-19

Particulars	`	`
Income taxable under section 115BBA		
Income from participation in matches in India	5,00,000	
Advertisement of product on TV	1,00,000	
Contribution of articles in newspaper	10,000	
Income taxable under section 115BB		
Income from horse races	20,000	
Total income	**6,30,000**	
Tax@ 20% under section 115BBA on ` 6,10,000		1,22,000
Tax@ 30% under section 115BB on income of ` 20,000 from horse races		6,000
		1,28,000
Add: Education cess@2% and SHEC@1%		3,840
Total tax liability of Smith for the A.Y.2018-19		**1,31,840**

(ii) Yes, the above income is subject to tax deduction at source.

Income referred to in section 115BBA (i.e., Rs.6,10,000, in this case) is subject to tax deduction at source@ 20% under section 194E.

Income referred to in section 115BB (i.e., Rs.20,000, in this case) is subject to tax deduction

at source@30% under section 194BB.

Since Smith is a non-resident, the amount of tax to be deducted calculated at the prescribed rates mentioned above, would be increased by education cess@2% and secondary and higher education cess@1%.

(iii) Section 115BBA provides that if the total income of the non-resident sportsman comprises of only income referred to in that section and tax deductible at source has been fully deducted, it shall not be necessary for him to file his return of income. However, in this case, Mr. Smith has income from horse races as well. Therefore, he cannot avail the benefit of exemption from filing of return of income as contained in section 115BBA. Hence, he would be liable to file his return of income for A.Y.2018-19.

(iv) The Calcutta High Court in Indcom v. CIT (TDS)(2011) 335 ITR 485 has held that 'match referee' would not fall within the meaning of "sportsmen" to attract the provisions of section 115BBA. Therefore, although the payments made to non-resident 'match referee' are "income" which has accrued and arisen in India, the same are not taxable under the provisions of section 115BBA. They are subject to the normal rates of tax.

Particulars		`
Tax@30% under section 115BB on winnings of ` 20,000 from horse races		6,000
Tax on ` 6,10,000 at the rates in force		
Upto ` 2,50,000	Nil	
2,50,000 – 5,00,000 @5%	12,500	
5,00,000 – 6,10,000 @ 20%	22,000	34,500
		40,500
Add: Education cess@2% and secondary and higher education cess@1%		1,215
		41,715

EXERCISE

Question 1

Piyush, who returned to India on 12th June, 2017 for permanently residing in India after a stay of about 20 years in U.K., provides the sources of his various incomes and seeks your opinion to know about his liability to income tax thereon in India in assessment year 2018-19:

(i) Income of rent of the flat in London which was deposited in a bank there. The flat was given on rent by him after his return to India since July, 2017.

(ii) Dividends on the shares of three German Companies which are being collected in a bank account in London. He proposes to keep the dividend on shares in London with the permission of the Reserve Bank of India.

(iii) He has got two sons, one of whom is of 12 years and other 19 years. Both his sons are staying

in London and not returning to India with him. Each of his sons is having income of Rs.75,000 in U.K. in foreign currency (not received in India) and of Rs.20,000 in India.

(iv) During the preceding accounting year when he was a non-resident, he had sold 1000 shares which were acquired by him in British Pound Sterling and the sale proceeds were repatriated. The profit in terms of British Pound Sterling on sale of these 1000 shares was 175% of the cost at Rs.37,500 while in terms of Indian Rupee it was Rs.50,000.

Answer

Piyush returned to India on 12th June 2017 for permanently residing in India after staying in UK for 20 years. During the P.Y.2017-18, he stays in India for 293 days. Since he has stayed in India for a period of 182 days or more during the previous year 2017-18, he would be a resident in India for the A.Y.2018-19. However, he would be a resident but not ordinarily resident, assuming that he was a non-resident in nine out of ten previous years preceding P.Y.2017-18 / his stay in India during the seven previous years is less than 730 days. The residential status of Piyush for A.Y.2018-19 is, therefore, **Resident but Not Ordinarily Resident.**

As per section 5(1), only income which is received/deemed to be received/accrued or arisen/deemed to accrue or arise in India is taxable in case of a Resident but not Ordinarily Resident. Income which accrues or arises outside India shall not be included in his total income, unless it is derived from a business controlled in, or a profession set up in, India.

(i) Rental income from a flat in London which was deposited in a bank there shall not be taxable in the case of a resident but not ordinarily resident, since both the accrual and receipt of income are outside India.

(ii) Dividends from shares of three German Companies, collected in a bank account in London, would also not be taxable in the case of a resident but not ordinarily resident since both the accrual and receipt of income are outside India.

(iii) As per section 64(1A), all income accruing or arising to a minor child is includible in the hands of the parent, after providing for deduction of Rs.1,500 per child under section 10(32).

Accordingly, income of Rs.20,000 accruing to his minor son, aged 12 years, in India is includible in the income of Piyush, after providing deduction of Rs.1,500. Therefore, `18,500 is includible in the income of Piyush. Income accruing to the minor child outside India (which is also received outside India) is not includible in the income of Piyush.

Since the other son is major, his income is not includible in the income of Piyush.

(iv) Repatriation of sale proceeds of 1000 shares sold in the preceding accounting year, when Piyush was a non-resident, is not taxable in the A.Y.2018-19 since it is not the income of the P.Y.2017-18.

Consequently, only the income includible under section 64(1A) would form part of the total income of Mr. Piyush for A.Y.2018-19. Since his total income (i.e., Rs.18,500) is less than the basic exemption limit, there would be no liability to income-tax for A.Y.2018-19.

Question 2

Arjun who works as a Finance Controller of ABC Ltd. was deputed to work at the company's office in U.K. on 26.09.2017 for a period of 2 years. He claims that he is a non-resident for the A.Y.2018-19. Is his claim valid? Discuss.

Answer

As per section 6, an individual is treated as resident if he has stayed for 182 days in India during the previous year or if he has stayed for 60 days in the current previous year and 365 days in total during the four preceding previous years. However, where an Indian citizen leaves India for the purpose of employment, he will be resident if he stayed for 182 days instead of 60 days during the previous year.

In the given case, Arjun is employed in India and he was deputed to work at the company's branch office in U.K. on 26.09.2017 for a period of 2 years. Since, Arjun leaves India for the purpose of employment, the condition of 182 days in the current previous year would only be applicable for treating him as resident. However, during the P.Y. 2017-18, he stayed in India for 179 days. Hence, his claim that he is non-resident for the A.Y. 2018-19, is valid.

Question 3

J, a citizen of India, employed in the Indian Embassy at Tokyo, Japan. He received salary and allowances at Tokyo from the Government of India for the year ended 31.3.2018 for services rendered by him in Tokyo. Besides, he was allowed perquisites by the Government. He is a non-resident for the assessment year 2018-19. Examine the taxability of salary, allowances and perquisites in the hands of J for the assessment year 2018-19.

Answer

As per section 9(1)(iii), salaries payable by the Government to a citizen of India for services rendered outside India shall be deemed to accrue or arise in India. As such, salary received by J is chargeable to tax, even though he was a non-resident for A.Y.2018-19.

As per section 10(7), all allowances or perquisites paid or allowed as such outside India by the Government to a citizen of India for rendering services outside India is exempt from tax. Therefore, the allowances and perquisites received by J are exempt as per section 10(7).

Question 4

Explain in the context of provisions of the Act, whether the income derived during the year ended on 31.03.2018 in the following case shall be subject to tax in the A.Y. 2018-19:

Mr. Ravi, an IAS Officer, was posted to USA by the Government of India on 11.07.17 for a period of three years. He was paid salary of Rs.3 lakhs for the period 01.04.17 to 10.07.17 and of Rs.12 lakhs for the period upto 31.03.18. He left India for USA in the night of 10.07.17 and did not come even for a day up till 31.03.2018.

Answer

The salary drawn by an IAS Officer by virtue of his posting in USA, despite the fact that he was a non-resident in the previous year, shall be subject to tax in India as per section 9(1)(iii) which states that income chargeable under the head "Salaries" payable by the Government to a citizen of India for his services outside India shall be deemed to accrue or arise in India. Therefore, the total amount of salary

of Rs.15 lakhs received by the IAS Officer in and outside India shall be subject to tax in India in the A.Y 2018-19.

Question 5

JJ Limited, a company incorporated in Australia has entered into an agreement with KK Limited, an Indian company for rendering technical services to the latter for setting up a fertilizer plant in Orissa. As per the agreement, JJ Limited rendered both off-shore services and on-shore services to KK Limited at fee of Rs. 1 crore and Rs. 1.5 crore, respectively. JJ Limited is of the view that it is not liable to tax in India in respect of fee of Rs.1 crore as it is for rendering services outside India. Discuss the correctness of the view of JJ Limited.

Answer

The Explanation below section 9(2) clarifies that income by way of, inter alia, fees for technical services from services utilized in India would be deemed to accrue or arise in India under section 9(1)(vii) in case of a non-resident and be included in his total income, whether or not such services were rendered in India.

In this case, the technical services rendered by the foreign company, JJ Ltd., were for setting up a fertilizer plant in Orissa. Therefore, the services were utilized in India. Consequently, as per section 9(2), the fee of Rs.2.5 Crore for technical services rendered by JJ Ltd. (both off-shore and on-shore services) to KK Ltd. is deemed to accrue or arise in India and includible in the total income of JJ Ltd.

Therefore, the view of JJ Ltd. that it is not liable to tax in India in respect of fee of `1 Crore (as it is for rendering services outside India) is not correct.

Question 6

Examine with reasons whether the following transactions attract income-tax in India, in the hands of recipients under section 9 of Income-tax Act, 1961:

(i) A non-resident German company, which did not have a permanent establishment in India, entered into an agreement for execution of electrical work in India. Separate payments were made towards drawings & designs, which were described as "Engineering Fee". The assessee contended that such business profits should be taxable in Germany as there is no business connection within the meaning of section 9(1)(i) of the Income-tax Act, 1961.

(ii) A firm of solicitors in Mumbai engaged a barrister in UK for arguing a case before Supreme Court of India. A payment of 5000 pounds was made as per terms of professional engagement.

(iii) Amount paid by Government of India for use of a patent developed by Mr. A, who is a non-resident.

(iv) Sai Engineering, a non-resident foreign company entered into a collaboration agreement on 25/6/2016, with an Indian Company and was in receipt of interest on 8% debentures for Rs.20 lakhs, issued by Indian Company, in consideration of providing technical know-how during previous year 2017-18.

Answer

(i) Fees for technical services is taxable under section 9(1)(vii). In this case, the separate payments made towards drawings and designs (described as "engineering fee") are in the nature of fee for technical services and, therefore, it is taxable in India by virtue of section 9(1)(vii) [Aeg Aktiengesllschaft v. CIT (2004) 267 ITR 209 (Kar.)].

As per Explanation to section 9, where income is deemed to accrue or arise in India under section 9(1)(vii), such income shall be included in the total income of the non-resident German company, regardless of whether it has a residence or place of business or business connection in India.

(ii) As per section 9(1)(i), all income accruing or arising, whether directly or indirectly, through or from any business connection in India is deemed to accrue or arise in India.

In this case, there was a professional connection between the firm of solicitors in Mumbai and the barrister in UK. The expression "business" includes not only trade and manufacture; it includes, within its scope, "profession" as well. Therefore, the existence of professional connection amounts to existence of "business connection" under section 9(1)(i). It was so held by the Supreme Court in Barendra Prasad Roy v. ITO (1981) 129 ITR 295.

Hence, the amount of 5,000 pounds paid to the barrister in UK as per the terms of the professional engagement constitutes income which is deemed to accrue or arise in India under section 9(1)(i). Hence, it is taxable in India.

(iii) As per section 9(1)(vi), income by way of royalty payable by the Government of India is deemed to accrue or arise in India. "Royalty" means consideration for, inter alia, use of patent. Therefore, the amount paid by Government of India for use of patent developed by Mr. A, a non-resident, is deemed to accrue or arise in India. Hence, it is taxable in India.

(iv) Rs.20 lakhs, being the value of debentures issued by an Indian company in consideration of providing technical know-how, is in the nature of fee for technical services, deemed to accrue or arise in India to Sai Engineering, a non-resident foreign company, under section 9(1)(vii). Hence, it is taxable in India.

Further, as per section 9(1)(v), income by way of interest payable by a person who is a resident of India is deemed to accrue or arise in India. Therefore, interest income from debentures of an Indian company is deemed to accrue or arise in India in the hands of Sai Engineering by virtue of section 9(1)(v). Hence, it is taxable in India.

Note – Since the question specifically requires the candidates to examine the taxability of the above transactions under section 9, the provisions of double taxation avoidance agreement, if any, applicable in the above cases, have not been taken into consideration.

Question 7

Z, an American tourist, comes to India for the first time on June 17, 2017. He leaves India on September 29, 2017. Determine his residential status for the assessment year 2018-19. Does it make any difference if he comes to India on a business trip or if he is an Indian citizen?

Answer

Previous year 2017-18: 105 [14+31+31+29]

Previous year 2016-17: Nil

Previous year 2015-16: Nil

and so on ……

He is non-resident for the assessment year 2018-19 as he does not satisfy any of the basic condition. It does not make any difference if he comes on a business trip to India.

Further, it does not make any difference if he is an Indian citizen as far as the answer of non-resident is concerned. But there is a difference in application of basic conditions as an Indian citizen who comes on a visit to India during the previous has the option of only one basic condition of 182 days to become a resident.

Question 8

M/s. Global Airlines incorporated as a company in USA operated its flights to India and vice versa during the year 2017-18 (April, 2017 to March, 2018) and collected charges of Rs.125 lakhs for carriage of passengers and cargo out of which Rs.65 lakhs were received in New York in U.S Dollars for the passenger fare booked from New York to Mumbai. The total expenses for the year on operation of such flights were Rs.195 lakhs. Compute the income chargeable to tax of the foreign airlines.

Answer

In the present case, the income chargeable to tax of M/s Global Airlines is as follows:

Particulars	Fare booked from India to outside India whether received in India or not (`)	Fare booked from New York to Mumbai (`)
Fare	60,00,000 (1,25,00,000 – 65,00,000)	65,00,000
Deemed income @5% u/s 44BBA	3,00,000 (60,00,000 × 5%)	Nil (since the amount not received in India)

Illustration 1

Examine the correctness or otherwise of the following statement with reference to the provisions of Income-tax Act, 1961.

The double taxation avoidance treaties entered into by the Government of India override the domestic law.

Solution

The statement is correct.

Section 90(2) provides that where a double taxation avoidance treaty is entered into by the Government, the provisions of the Income-tax Act, 1961 would apply to the extent they are more beneficial to the assessee.

In case of any conflict between the provisions of the double taxation avoidance agreement and the Income-tax Act, 1961, the provisions of the DTAA would prevail over the Act in view of the provisions of section 90(2), to the extent they are more beneficial to the assessee [CIT v. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654 (SC)].

Illustration 2

Nandita, an individual resident retired employee of the Prasar Bharati aged 60 years, is a well -known dramatist deriving income of 1,10,000 from theatrical works played abroad. Tax of 11,000 was deducted in the country where the plays were performed. India does not have any Double Tax Avoidance Agreement under section 90 of the Income -tax Act, 1961, with that country. Her income in India amounted to 5,10,000. In view of tax planning, she has deposited 1,50,000 in Public Provident Fund and paid contribution to approved Pension Fund of LIC 32,000. She also contributed 28,000 to Central Government Health Scheme during the previous year and gave payment of medical insurance premium of 26,000 to insure the health of her father, a non-resident aged 84 years, who is not dependent on her. Compute the tax liability of Nandita for the Assessment year 2018-19.

Solution

Computation of tax liability of Nandita for the A.Y. 2018-19

Particulars	`	`
Indian Income		5,10,000
Foreign Income		1,10,000
Gross Total Income		**6,20,000**
Less: Deduction under section 80C		
Deposit in PPF	1,50,000	
Under section 80CCC		
Contribution to approved Pension Fund of LIC	32,000	
580	1,82,000	

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Under section 80CCE		
The aggregate deduction under section 80C, 80CCC and 80CCD(1) has to be restricted to 1,50,000	1,50,000	
Under section 80D		
Contribution to Central Government Health Scheme 28,000 is also allowable as deduction under section 80D. Since she is a resident senior citizen, the deduction is allowable to a maximum of 30,000 **(See Note 1)**	28,000	
Medical insurance premium of 26,000 paid for father aged 84 years. Since the father is a non-resident in India, he will not be entitled for the higher deduction of 30,000 eligible for a senior citizen, who is resident in India. Hence, the deduction will be restricted to maximum of 25,000.	25,000	2,03,000
Total Income		**4,17,000**
Tax on Total Income		
Income-tax (See Note below)		5,850
Add : Education cess @2%		117
Add: SHEC @1%		58
		6,025
Average rate of tax in India (i.e. 6,025/ 4,17,000 × 100)	1.445%	
Average rate of tax in foreign country (i.e. 11,000/ 1,10,000 ×100)	10%	
Rebate under section 91 on 1,10,000 @ 1.445% (lower of average Indian-tax rate or average foreign tax rate)		1,589
Tax payable in India (6,025 – 1,589)		**4,436**

Notes:

1. Section 80D allows a higher deduction of up to 30,000 in respect of the medical premium paid to insure the heath of a senior citizen. Therefore, Nandita will be allowed deduction of 28,000 under section 80D, since she is a resident Indian of the age of 60 years.
2. The basic exemption limit for senior citizens is 3,00,000 and the age criterion for qualifying as a "senior citizen" for availing the higher basic exemption limit is 60 years. Accordingly, Nandita is eligible for the higher basic exemption limit of 3,00,000, since she is 60 years old.
3. An assessee shall be allowed deduction under section 91 provided all the following conditions are fulfilled:-
   (a) The assessee is a resident in India during the relevant previous year.
   (b) The income accrues or arises to him outside India during that previous year.

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(c) Such 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 and the assessee has paid tax on such income in the foreign country.

(e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.

In this case, since all the above conditions are satisfied, Nandita is eligible for deduction under section 91.

Question 1

Cosmos Limited, a company incorporated in Mauritius, has a branch office in Hyderabad opened in April, 2017. The Indian branch has filed return of income for assessment year 201 8-19 disclosing income of 50 lacs. It paid tax at the rate applicable to domestic company i.e. 30% plus education cess on the basis of paragraph 2 of Article 24 (Non-Discrimination) of the Double Taxation Avoidance Agreement between India and Mauritius, which reads as follows:

"The taxation on a permanent establishment which an enterprise of a Contracting Stat e has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities in the same circumstances."

However, the Assessing Officer computed tax on the Indian branch at the rate applicable to a foreign company i.e. 40% plus education cess.

Is the action of the Assessing Officer in accordance with law?

Answer

Under section 90(2), where the Central Government has entered into an agreement for avoidance of double taxation with the Government of any country outside India or specified territory outside India, as the case may be, then, in relation to the assessee to whom such agreement applies, the provisions of the Income-tax Act, 1961 shall apply to the extent they are more beneficial to the assessee. Thus, in view of paragraph 2 of the Article 24 (Non-discrimination of the Double Taxation Avoidance Agreement (DTAA), it appears that the Indian branch of Cosmos Limited, incorporated in Mauritius, is liable to tax in India at the rate applicable to domestic company (30%), which is lower than the rate of tax applicable to a foreign company (40%).

However, Explanation 1 to section 90 clarifies that 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. Therefore , in view of this Explanation, the action of the Assessing Officer in levying tax@40% on the Indian branch of Cosmos Ltd. is in accordance with law.

Question 2

Kalpesh Kumar, a resident individual, is a musician deriving income of 7,50,000 from concerts performed outside India. Tax of 1,00,000 was deducted at source in the country where the concerts were performed. India does not have any double tax avoidance agreement with that country. His income in India amounted to 30,00,000. Compute tax liability of Kalpesh Kumar for the assessment year 2018-19 assuming he has deposited 1,50,000 in Public Provident Fund and paid medical insurance premium in respect of his father, resident in India,

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aged 65 years,
32,000.

Answer

Computation of tax liability of Mr. Kalpesh for A.Y.2018-19

Particulars	`	`
Indian Income		30,00,000
Foreign Income		7,50,000
Gross Total Income		**37,50,000**
Less: **Deduction under section 80C**		
PPF Contribution	1,50,000	
Deduction under section 80D		
Medical insurance premium of father, being a resident senior citizen, restricted to	30,000	1,80,000
Total Income		**35,70,000**
Tax on total income		8,83,500
Add: Education cess @ 2%		17,670
Secondary and higher education cess @ 1%		8,835
		9,10,005
Average rate of tax in India [i.e., 9,10,005 /35,70,000 x 100]	25.49%	
Average rate of tax in foreign country [i.e. 1,00,000/ 7,50,000 x 100]	13.333%	
Doubly taxed income	7,50,000	
Rebate under section 91 on 7,50,000 @13.33% (lower of average Indian tax rate and foreign tax rate]		1,00,000
Tax payable in India [9,10,005 – 1,00,000]		**8,10,005**

Note: An assessee shall be allowed deduction under section 91 provided all the following conditions are fulfilled:-

(a) The assessee is a resident in India during the relevant previous year.

(b) The income accrues or arises to him outside India during that previous year.

(c) Such 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 and the assessee has paid tax on such income in the foreign country.

(e) There is no agreement under section 90 for the relief or avoidance of double taxation between India and the other country where the income has accrued or arisen.

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In this case, Kalpesh Kumar is eligible for deduction under section 91 since all the above conditions are fulfilled.

Question 3

The following are the particulars of income earned by Miss Vivitha, a resident Indian aged 25, for the assessment year 2018-19:

	(In lacs)
Income from playing snooker matches in country L	12.00
Tax paid in country L	1.80
Income from playing snooker tournaments in India	19.20
Life Insurance Premium paid	1.10
Medical Insurance Premium paid for her father aged 62 years (paid through credit card)	0.32

Compute her total income and tax liability for the assessment year 2018 -19. There is no Double Taxation Avoidance Agreement between India and country L.

Answer

Computation of total income and tax liability of Miss Vivitha for the A.Y. 2018 -19

Particulars	`	`
Indian Income [Income from playing snooker tournaments in India]		19,20,000
Foreign Income [Income from playing snooker matches in country L]		12,00,000
Gross Total Income		**31,20,000**
Less: Deduction under Chapter VIA		
Deduction under section 80C		
Life insurance premium of 1,10,000 paid during the previous year deduction, is within the overall limit of 5 lakh. Hence, fully allowable as deduction	1,10,000	
Deduction under section 80D		
Medical insurance premium of 32,000 paid for her father aged 62 years. Since her father is a senior citizen, the deduction is allowable to a maximum of 30,000 (assuming that her father is also a resident in India). Further, deduction is allowable where payment is made by any mode other than cash. Here payment is made by credit card hence, eligible for deduction.	30,000	1,40,000
Total Income		**29,80,000**

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Tax on Total Income		
Income-tax		7,06,500
Add : Education cess @ 2%		14,130
Add: Secondary and higher education cess @ 1%		7,065
		7,27,695
Average rate of tax in India (i.e. 7,27,695/29,80,000 × 100)	24.42%	
Average rate of tax in foreign country (i.e. 1,80,000/ ` 12,00,000 ×100)	15.00%	
Rebate under section 91 on 12 lakh @ 15% (lower of average Indian-tax rate or average foreign tax rate)		1,80,000
Tax payable in India (7,27,695 – 1,80,000)		**5,47,695**

Note : Miss Vivitha shall be allowed deduction under section 91, since the following conditions are fulfilled:-

(a) She is a resident in India during the relevant previous year.

(b) The income accrues or arises to her outside India during that previous year and such income is not deemed to accrue or arise in India during the previous year.

(c) The income in question has been subjected to income-tax in the foreign country L in her hands and she has paid tax on such income in the foreign country L.

(d) There is no agreement under section 90 for the relief or avoidance of double taxation between India and country L where the income has accrued or arisen.

Question 4

The concept of Permanent Establishment is one of the most important concepts in determining the tax implications of cross border transactions. Examine the significance thereof, when such

transactions are governed by Double Taxation Avoidance Agreements (DTAA).

Answer

Double Taxation Avoidance Agreements (DTAAs) generally contain an Article providing that business income is taxable in the country of residence, unless the enterprise has a permanent establishment in the country of source, and such income can be attributed to the permanent establishment.

As per section 92F(iiia), the term "Permanent Establishment" includes a fixed place of business through which the business of an enterprise is wholly or partly carried on.

As per this definition, to constitute a permanent establishment, there must be a place of business which is fixed and the business of the enterprise must be carried out wholly or partly through this place.

Section 9(1)(i) requires existence of business connection for deeming business income to accrue or arise in India. DTAAs however provide that business income is taxable only if there is a permanent establishment in India.

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Therefore, in cases covered by DTAAs, where there is no permanent establishment in India, business income cannot be brought to tax due to existence of business connection as per section 9(1)(i).

However, in cases not covered by DTAAs, business income attributable to business connection is taxable.

Question 5

An individual resident in India, having income earned outside India in a country with which no agreement under section 90 exists, asks you to Examine whether the credit for the tax paid on the foreign income will be allowed against his income-tax liability in India.

Answer

The assessee is a resident in India and accordingly, the income accruing or arising to him globally is chargeable to tax in India. However, section 91 specifies that if a person resident in India has paid tax in any country with which no agreement under section 90 exists, then, for the purpose of relief or avoidance of double taxation, **a deduction is allowed from the Indian income-tax payable by him, of a sum calculated on such doubly taxed income at Indian rate of tax or the rate of tax of such foreign country, whichever is lower, or at the Indian rate of tax, if both the rates are equal.** Accordingly, the assessee shall not be given any credit of the tax paid on the income in other country, but shall be allowed a deduction from the Indian income -tax payable by him as per the scheme of section 91.

Question 6

The Income-tax Act, 1961 provides for taxation of a certain income earned by Mr. X. The Double Taxation Avoidance Agreement, which applies to Mr. X, excludes the income earned by Mr. X from the purview of tax. Is Mr. X liable to pay tax on the income earned by him? Examine.

Answer

Section 90(2) makes it clear that where the Central Government has entered into a Double Taxation Avoidance Agreement with a country outside India, then **in respect of an assessee to whom such agreement applies, the provisions of the Act shall apply to the extent they are more beneficial to the assessee.** This means that where tax liability is imposed by the Act, the Double Taxation Avoidance Agreement may be resorted to for reducing or avoiding the tax liability.

However, as per section 90(4), the assessee, in order to claim relief under the agreement, has to obtain a certificate [Tax Residence Certificate (TRC)] from the Government of that country, declaring the residence of the country outside India. Further, he also has to provide the following information in Form No. 10F:

(i) Status (individual, company, firm etc.) of the assessee;

(ii) PAN of the assessee, if allotted;

(iii) Nationality (in case of an individual) or country or specified territory of incorporation or registration (in case of others);

(iv) Assessee's tax identification number in the country or specified territory of residence and in case there is no such number, then, a unique number on the basis of which the person is identified by the Government of the country or the specified territory of which the asse ssee claims to be a

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resident;

(v) Period for which the residential status, as mentioned in the certificate referred to in section 90(4) or section 90A(4), is applicable; and

(vi) Address of the assessee in the country or specified territory outside India, during th e period for which the certificate, as mentioned in (v) above, is applicable.

However, the assessee may not be required to provide the information or any part thereof, if the information or the part thereof, as the case may be, is already contained in the TRC referred to in section 90(4) or section 90A(4).

The Supreme Court has held, in CIT v. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654, that in case of any conflict between the provisions of the Double Taxation Avoidance Agreement and the Income-tax Act, 1961, the provisions of the Double Taxation Avoidance Agreement would prevail over those of the Income-tax Act, 1961. Mr. X is, therefore, not liable to pay tax on the income earned by him provided he submits the Tax Residence Certificate obtained from the government of the other country, and provides such other documents and information as may be prescribed.

Question 7

Arif is a resident of both India and another foreign country in the previous year 2017 -18. He owns immovable properties (including residential house) in both the countries. He earned income of 50 lacs from rubber estates in the foreign country during the financial year 201 7-18. He also sold some house property situated in foreign country resulting in short-term capital gain of 10 lacs during the year. Arif has no permanent establishment of business in India. However, he has derived rental income of 6 lacs from property let out in India and he has a house in Lucknow where he stays during his visit to India.

Article 4 of the Double Taxation Avoidance Agreement between India and the foreign country where Arif is a resident, provides that "where an individual is a resident of both the Contracting States, then he shall be deemed to be resident of the Contracting State in which he has permanent home available to him. If he has permanent home in both the Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closer (centre of vital interests)".

You are required to examine with reasons whether the business income of Arif arising in foreign country and the capital gains in respect of sale of the property situated in foreign country can be taxed in India.

Answer

Section 90(1) of the Income-tax Act, 1961 empowers the Central Government to enter into an agreement with the Government of any country outside India for avoidance of double taxation of income under the Indian law and the corresponding law of that country. Section 90(2) provides that where the Central Government has entered into an agreement with the Government of any other country 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 the Income-tax Act, 1961 shall apply to the extent they are more beneficial to that assessee.

Arif has residential houses both in India and foreign count ry. Thus, he has a permanent home in both the countries. However, he has no permanent establishment of business in India. The Double Taxation

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Avoidance Agreement (DTAA) with foreign country provides that where an individual is a resident of both the countries, he shall be deemed to be resident of that country in which he has a permanent home and if he has a permanent home in both the countries, he shall be deemed to be resident of that country, which is the centre of his vital interests i.e. the country wit h which he has closer personal and economic relations.

Arif owns rubber estates in a foreign country from which he derives business income. However, Arif has no permanent establishment of his business in India. Therefore his personal and economic relations with foreign country are closer, since foreign country is the place where –

(a) the property is located and

(b) the permanent establishment (PE) has been set-up

Therefore, he shall be deemed to be resident of the foreign country for A.Y. 201 8-19.

The fact of the case and issues arising therefrom are similar to that of CIT vs. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654, where the Supreme Court held that if an assessee is deemed to be a resident of a contracting State where his personal and economic relations are closer, then in such acase, the fact that he is a resident in India to be taxed in terms of sections 4 and 5 would become irrelevant, since the DTAA prevails over sections 4 and 5.

However, as per section 90(4), in order to claim relief under the agreement, Arif has to obtain a certificate [Tax Residency Certificate (TRC)] declaring his residence of the country outside India from the Government of that country. Further, he also has to provide such other documents and information, as may be prescribed.

Therefore, in this case, Arif is not liable to income tax in India for assessment year 201 8-19 in respect of business income and capital gains arising in the foreign country provided he furnishes the Tax Residency Certificate and provides such other documents and information as may be prescribed.

Question 8

Mr. Kamesh, an individual resident in India furnishes you the following particulars of income earned in India, Country "X" and Country "Y" for the previous year 2017-18. India has not entered into double taxation avoidance agreement with these two countries.

Particulars	`
Income from profession carried on in India	7,50,000
Agricultural income in Country "X" (gross)	50,000
Dividend received from a company incorporated in Country "Y" (gross)	1,50,000
Royalty income from a literary book from Country "X" (gross)	6,00,000
Expenses incurred for earning royalty	50,000
Business loss in Country "Y" (Proprietary business)	65,000
Rent from a house situated in Country "Y" (gross)	2,40,000

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Municipal tax in respect of the above house (not allowed as deduction in country "Y")	10,000

Note: Business loss in Country "Y" not eligible for set off against other incomes as per law of that country.

The rates of tax in Country "X" and Country "Y" are 10% and 25%, respectively.

Compute total income and tax payable by Mr. Kamesh in India for Assessment Year 2018 -19.

Answer:

Computation of total income of Mr. Kamesh for A.Y.2018-19

Particulars	`	`
Income from House Property [House situated in country Y]		
Gross Annual Value[1]	2,40,000	
Less: Municipal taxes (assumed as paid in that country)	10,000	
Net Annual Value	2,30,000	
Less: Deduction under section 24 – 30% of NAV	69,000	
		1,61,000
Profits and Gains of Business or Profession		
Income from profession carried on in India	7,50,000	
Less: Business loss in country Y set-off[2]	65,000	
		6,85,000
Income from Other Sources		
Agricultural income in country X	50,000	
Dividend received from a company in country Y	1,50,000	
Royalty income from a literary book from Country X (after deducting expenses of 50,000)	5,50,000	7,50,000
Gross Total Income		**15,96,000**
Less: Deduction under Chapter VIA **Under section 80QQB** – Royalty income of a resident from literary work[3]		3,00,000
Total Income		**12,96,000**

Computation of tax liability of Mr. Kamesh for A.Y.2018-19

[1] Rental Income has been taken as GAV in the absence of other information relating to fair rent, municipal value etc.

[2] As per section 70(1), inter-source set-off of income is permitted.

[3] It is assumed that the royalty earned outside India has been brought into India in convertible foreign exchange within a period of six months from the end of the previous year.

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Particulars	`
Tax on total income [30% of 2,96,000 + 1,12,500][4]	2,01,300
Add: Education cess@2%	4,026
Secondary and higher education cess @ 1%	2,013
	2,07,339
Less: Rebate under section 91 **(See Working Note below)**	69,360
Tax Payable	**1,37,979**
Tax payable (rounded off)	1,37,980

Working Note: Calculation of Rebate under section 91	`	`
Average rate of tax in India [i.e., 2,07,339 / 12,96,000 x 100]	**16%**	
Average rate of tax in country X	**10%**	
Doubly taxed income pertaining to country X		
Agricultural Income	50,000	
Royalty Income [6,00,000 – 50,000 (Expenses) – 3,00,000 (deduction under section 80QQB)][5]	2,50,000	
	3,00,000	
Rebate under section 91 on 3,00,000 @10% [being the lower of average Indian tax rate (16%) and foreign tax rate (10%)]		30,000
Average rate of tax in country Y	**25%**	
Doubly taxed income pertaining to country Y		
Income from house property	1,61,000	
Dividend	1,50,000	
	3,11,000	
Less: Business loss set-off	65,000	
	2,46,000	
Rebate under section 91 on 2,46,000 @16% (being the lower of average Indian tax rate (16%) and foreign tax rate (25%)]		39,360
Total rebate under section 91 (Country X + Country Y)		**69,360**

[4] It is assumed that Mr. Kamesh is not a senior citizen or very senior citizen

[5] Doubly taxed income includes only that part of income which is included in the assessees total income. The amount deducted under Chapter VIA is not doubly taxed and hence, no relief is allowable in respect of such amount – CIT v. Dr. R.N. Jhanji (1990) 185 ITR 586 (Raj.).

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Note: Mr. Kamesh shall be allowed deduction under section 91, since the following conditions are fulfilled:- He is a resident in India during the relevant previous year (i.e., P.Y.2017-18).

(a) The income in question accrues or arises to him outside India in foreign countries X and Y during that previous year and such income is not deemed to accrue or arise in India during the previous year.

(b) The income in question has been subjected to income-tax in the foreign countries X and Y in his hands and it is presumed that he has paid tax on such income in those countries.

(c) There is no agreement under section 90 for the relief or avoidance of double taxation between sIndia and Countries X and Y where the income has accrued or arisen.

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Illustration 1

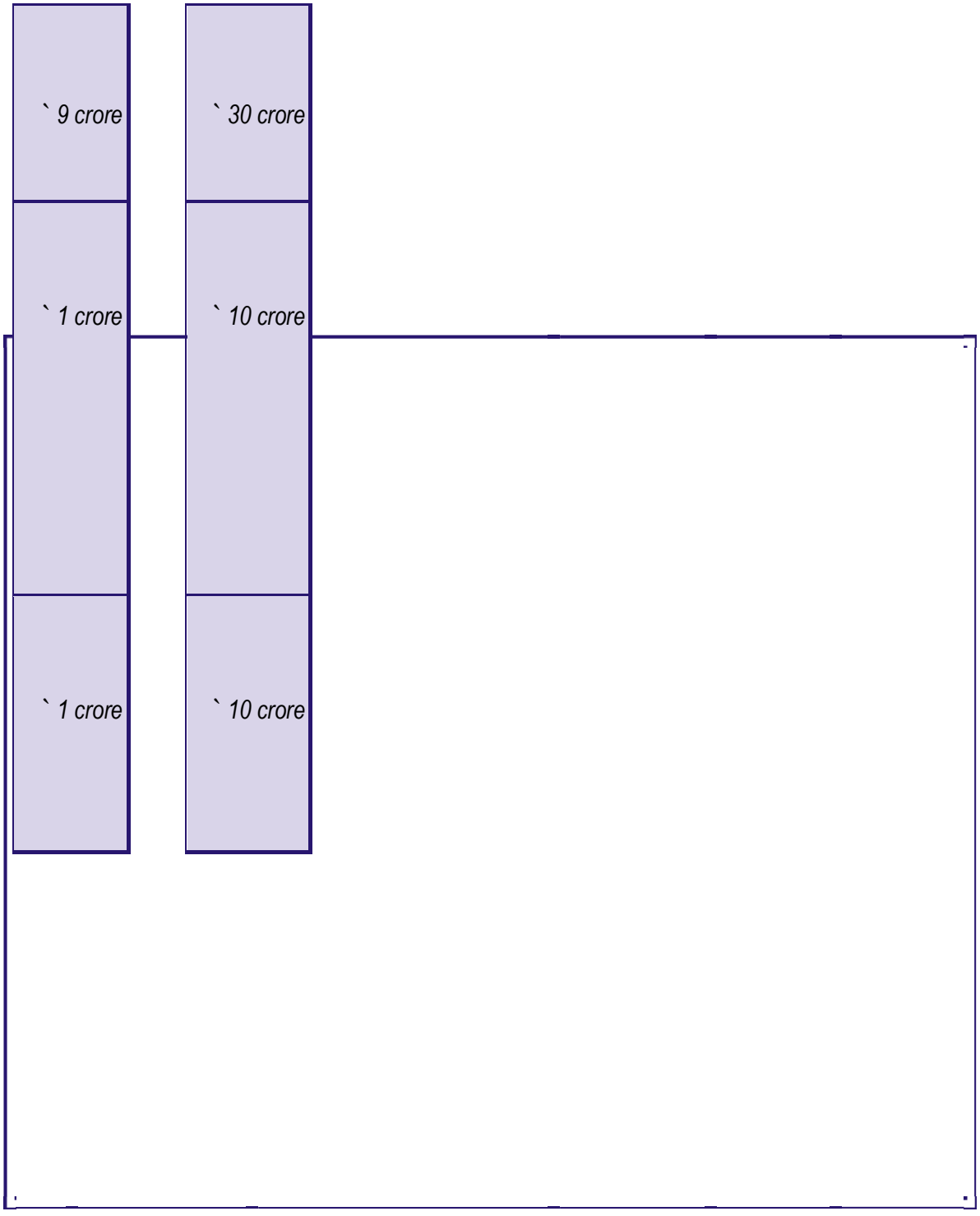
Examine the following transactions and discuss whether the transfer price declared by the following assessees, who have exercised a valid option for application of safe harbour rules, can be accepted by the Income-tax Authorities –

	Assessee	International transaction	Aggregate value of transactions entered into in the P.Y.2017-18	Declared Operating Profit Margin	Operating Expense
(1)	A Ltd., an Indian company	Provision of system support services to X Inc., which is a "specified foreign company" in relation to A Ltd.	` 95 crore	` 12 crore	` 75 crore
(2)	B Ltd., an Indian company	Provision of data processing services with the use of information technology to Y Inc., its foreign subsidiary.	` 180 crore	` 30 crore	` 150 crore
(3)	C & Co., a partnership firm registered under the Partnership Act, 1932	Provision of contract R & D services relating to development of internet technology, to XYZ & Co., a foreign firm, which holds 12% interest in C & Co.	` 175 crore	` 30 crore	` 150 crore

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(4)	*D Ltd., an Indian company*	*Provision of contract R & D services relating to generic pharmaceutical drug, to ABC Inc., a foreign company which guarantees 15% of the total borrowings of D Ltd.*	*` 50 crore*
(5)	*Sole proprietary concern of Mr. E, solely engaged in the original manufacture and export of automobile transmission and steering parts.*	*100% export of automobile transmission and steering parts to LMN LLP, a foreign LLP, controlled by Mr. E jointly with his relatives.*	*` 12 crore*
(6)	*F Ltd. an Indian company, solely engaged in the original manufacture and export of non-core auto components.*	*100% export of non-core auto components to GKG Inc., a foreign company. F Ltd. appoints two-thirds of the Board of Directors of GKG Inc.*	*` 12 crore*

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In all the above cases, it may be assumed that the Indian entity which provides the services assumes insignificant risk. It may also be assumed that the foreign entities referred to above are non-resident in India. Would your answer change, if in any of the cases mentioned above, the foreign entity is located in a notified jurisdictional area?

Solution

Section 92CB(1) provides that the determination of arm's length price under section 92C or section

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92CA shall be subject to safe harbour rules. Safe harbour means circumstances in which the income tax authorities shall accept the transfer price declared by the assessee. Section 92CB(2) empowers the CBDT to prescribe such safe harbour rules or circumstances under which the transfer price declared by the assessee shall be accepted by the Income-tax Authorities.

Accordingly, in exercise of the powers conferred by section 92CB read with section 295 of the

Income-tax Act, 1961, the CBDT has, vide Notification No.46/2017 dated 7.6.2017, prescribed safe harbour rules. Rule 10TD provides that where an eligible assessee has entered into an eligible international transaction and the option exercised by the said assessee is not held to be invalid under Rule 10TE, the transfer price declared by the assessee in respect of such transaction shall be accepted by the income-tax authorities, if it is in accordance with the circumstances set out thereunder.

An eligible assessee is a person who has exercised a valid option for application of safe harbour rules and is engaged in, inter alia, providing the following services, with insignificant risk, to a non- resident associated enterprise –

(i) software development services; or

(ii) information technology enabled services; or

(iii) contract R & D services wholly or partly relating to software development; or

(iv) contract R & D services wholly or partly relating to generic pharmaceutical drugs; or

(v) manufacture and export of core auto components; or

(vi) manufacture and export of non-core auto components

A person who is engaged in the manufacture and export of core or non-core auto components and where 90% or more of total turnover during the relevant previous year is in the nature of original equipment manufacturer sales also falls within the definition of eligible assessee if he has exercised a valid option for application of safe harbour rules.

(1) X Inc. is a specified foreign company in relation to A Ltd. Therefore, the condition of A Ltd. holding shares carrying not less than 26% of the voting power in X Inc is satisfied. Hence, X Inc. and A Ltd. are deemed to be associated enterprises. Therefore, provision of systems support services by A Ltd., an Indian company, to X Inc., a foreign company, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

Systems support services falls within the definition of "software development services", and hence, is an eligible international transaction. Since A Ltd. is providing software development services to a non-resident associated enterprise and has exercised a valid option for safe harbour rules, it is an eligible assessee.

Since the value of international transactions entered does not exceed Rs. 100 crore, A Ltd. should have declared an operating profit margin of not less than 17% in relation to operating expense, to be covered within the safe harbour rules. However, since A Ltd. has declared an operating profit margin of only 16% $\left(\text{i.e., } \frac{12}{75} \times 100\right)$, the same is not in

accordance with the circumstance mentioned in Rule 10TD. Hence, it is not binding on the

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income-tax authorities to accept the transfer price declared by A Ltd.

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(2) Y Inc., a foreign company, is a subsidiary of B Ltd., an Indian company. Hence, Y Inc. and B Ltd. are associated enterprises. Therefore, provision of data processing services by B Ltd., an Indian company, to Y Inc., a foreign company, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

Data processing services with the use of information technology falls within the definition of "information technology enabled services", and is hence, an eligible international transaction. Since B Ltd. is providing data processing services to a non-resident associated enterprise and has exercised a valid option for safe harbour rules, it is an eligible assessee.

Since the aggregate value of transactions entered into in the P.Y.2017-18 exceeds Rs. 100 crore but does not exceed Rs. 200 crore, B Ltd. should have declared an operating profit margin of not less than 18% in relation to operating expense, to be covered within the scope of safe harbour rules. In this case, since B Ltd. has declared an operating profit margin of 20% $\left(\text{i.e., } \frac{30}{150} \times 100\right)$, the same is in accordance with the circumstance mentioned in Rule 10TD. Hence, the income-tax authorities shall accept the transfer price declared by B Ltd in respect of such international transaction.

(3) XYZ & Co., a foreign firm holds 12% interest in C & Co., an Indian firm. Therefore, the condition of one enterprise, being a foreign firm, holding not less than 10% interest in another enterprise, being an Indian firm, is satisfied. Hence, XYZ & Co. and C & Co. are deemed to be associated enterprises. Therefore, provision of contract R & D services relating to software development by C & Co., an Indian firm, to XYZ & Co., a foreign firm, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

Development of internet technology falls within the meaning of "contract R&D services wholly or partly relating to software development", and hence, is an eligible international transaction. Since C & Co., an Indian firm, is providing contract R & D services to a non-resident associated enterprise and has exercised a valid option for safe harbour rules, it is an eligible assessee.

Since the value of the international transaction does not exceed Rs. 200 crore, C & Co. should have declared an operating profit margin of not less than 24% in relation to operating expense, to be covered within the safe harbour rules. However, since C & Co. has declared an operating profit margin of only 20% $\left(\text{i.e., } \frac{30}{150} \times 100\right)$, the same is not in accordance with the circumstance mentioned in Rule 10TD. Hence, it is not binding on the income-tax authorities to accept the transfer price declared by C & Co.

(4) ABC Inc., a foreign company, guarantees 15% of the total borrowings of D Ltd., an Indian company. Since ABC Inc. guarantees not less than 10% of the total borrowings of D Ltd., ABC Inc. and D Ltd. are deemed to be associated enterprises. Therefore, provision of

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contract R & D services relating to generic pharmaceutical drug by D Ltd., an Indian company, to ABC Inc., a foreign company, is an international transaction between associated enterprises, and consequently, the provisions of transfer pricing are attracted in this case.

Provision of contract R& D services in relation to generic pharmaceutical drug is an eligible international transaction. Since D Ltd. is providing such services to a non-resident associated enterprise and has exercised a valid option for safe harbour rules, it is an eligible assessee.

Since the value of the international transaction does not exceed Rs. 200 crore, D Ltd. should have declared an operating profit margin of not less than 24% in relation to operating expense, to be covered within the scope of safe harbour rules. In this case, since D Ltd. has declared an operating profit margin of 30% $\left(\text{i.e., } \frac{9}{30} \times 100\right)$, the same is in accordance with the circumstance mentioned in Rule 10TD. Hence, the income-tax authorities shall accept the transfer price declared by D Ltd in respect of such international transaction.

(5) LMN LLP, a foreign LLP, is controlled by Mr. E jointly with his relatives. Mr. E also has control over his own sole proprietorship concern. Therefore, the sole proprietorship concern of Mr. E in India and LMN LLP are deemed to be associated enterprises.

Automobile transmission and steering parts fall within the meaning of "core auto components", and hence, 100% export of all such parts originally manufactured by the sole proprietorship concern of Mr. E is an eligible international transaction. Since the sole proprietorship concern of Mr. E is solely engaged in the original manufacture and 100% export of such parts and has exercised a valid option for safe harbour rules, it is an eligible assessee.

The sole-proprietorship concern of Mr. E should have declared an operating profit margin of not less than 12% in relation to operating expense, to be covered within the safe harbour rules. However, since A Ltd. has declared an operating profit margin of only 10% $\left(\text{i.e., } \frac{1}{10} \times 100\right)$, the same is not in accordance with the circumstance mentioned in Rule 10TD. Hence, it is not binding on the income-tax authorities to accept the transfer price declared by Mr. E.

(6) F Ltd. and GKG Inc. are deemed to be associated enterprises since F Ltd. appoints more than half of the Board of Directors of GKG Inc. Manufacture and export of non-core auto components is an eligible international transaction. Since F Ltd. is engaged in original manufacture of non-core auto components and 100% export of the same, it is an eligible assessee.

F Ltd. should have declared an operating profit margin of not less than 8.5% in relation to operating expense, to be covered within the scope of safe harbour rules. In this case, since F Ltd. has declared an operating profit margin of 10% $\left(\text{i.e., } \frac{1}{10} \times 100\right)$, the same is in

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accordance with the circumstance mentioned in Rule 10TD. Hence, the income-tax authorities shall accept the transfer price declared by F Ltd in respect of such international transaction.

The safe harbour rules shall not apply in respect of eligible international transactions entered into with an associated enterprise located in a notified jurisdictional area. Therefore, if in any of the cases mentioned above, the foreign entity is located in a NJA, the safe harbour rules shall not be applicable, irrespective of the operating profit margin declared by the assessee.

Question 1

Under rule 10MA(2)(ii) there is a condition that the return of income for the relevant roll back year has been or is furnished by the applicant before the due date specified in Explanation 2 to section 139(1). It is not clear as to whether applicants who have filed returns under section 139(4) or 139(5) of the Act would be eligible for roll back.

Answer

The return of income under section 139(5) can be filed only when a return under section 139(1) has already been filed. Therefore, the return of income filed under section 139(5) of the Act, replaces the original return of income filed under section 139(1). Hence, if there is a return which is filed under section 139(5) to revise the original return filed before the due date specified in Explanation 2 to sub-section (1) of section 139, the applicant would be entitled for rollback on this revised return of income.

However, rollback provisions will not be available in case of a return of income filed under section 139(4) because it is a return which is not filed before the due date.

Question 2

Rule 10MA(2)(i) mandates that the rollback provision shall apply in respect of an international transaction that is same as the international transaction to which the agreement (other than the rollback provision) applies. It is not clear what is the meaning of the word "same". Further,it is not clear whether this restriction also applies to the Functions, Assets, Risks (FAR) analysis.

Answer

The international transaction for which a rollback provision is to be allowed should be the same as the one proposed to be undertaken in the future years and in respect of which the agreement has been reached. There cannot be a situation where rollback is finalised for a transaction which is not covered in the agreement for future years. The term same international transaction implies that the transaction in the rollback year has to be of same nature and undertaken with the same associated enterprise(s), as proposed to be undertaken in the future years and in respect of which agreement has been reached. In the context of FAR analysis, the restriction would operate to ensure that rollback provisions would apply only if the FAR analysis of the rollback year does not differ materially from the FAR validated for the purpose of reaching an agreement in respect of international transactions to be undertaken in the future years for which the agreement applies.

The word "materially" is generally being defined in the Advance Pricing Agreements being entered into by CBDT. According to this definition, the word "materially" will be interpreted consistently with its ordinary definition and in a manner that a material change of facts and circumstances

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would be understood as a change which could reasonably have resulted in an agreement with significantly different terms and conditions.

Question 3

Rule 10MA(2)(iv) requires that the application for rollback provision, in respect of an international transaction, has to be made by the applicant for all the rollback years in which the said international transaction has been undertaken by the applicant. Clarification is required as to whether rollback has to be requested for all four years or applicant can choose the years out of the block of four years.

Answer

The applicant does not have the option to choose the years for which it wants to apply for rollback. The applicant has to either apply for all the four years or not apply at all. However, if the covered international transaction(s) did not exist in a rollback year or there is some disqualification in a rollback year, then the applicant can apply for rollback for less than four years. Accordingly, if the covered international transaction(s) were not in existence during any of the rollback years, the applicant can apply for rollback for the remaining years. Similarly, if in any of the rollback years for the covered international transaction(s), the applicant fails the test of the rollback conditions contained in various provisions, then it would be denied the benefit of rollback for that rollback year. However, for other rollback years, it can still apply for rollback.

Question 4

Rule 10MA(3) states that the rollback provision shall not be provided in respect of an international transaction for a rollback year if the determination of arm's length price of the said international transaction for the said year has been the subject matter of an appeal before the Appellate Tribunal and the Appellate Tribunal has passed an order disposing of such appeal at any time before signing of the agreement. Further, Rule 10 RA(4) provides that if any appeal filed by the applicant is pending before the Commissioner (Appeals), Appellate Tribunal or the High Court for a rollback year, on the issue which is subject matter of the rollback provision for that year, the said appeal to the extent of the subject covered under the agreement shall be withdrawn by the applicant.

There is a need to clarify the phrase "Tribunal has passed an order disposing of such appeal" and on the mismatch, if any, between Rule 10MA(3) and Rule 10RA(4).

Answer

The reason for not allowing rollback for the international transaction for which Appellate Tribunal has passed an order disposing of an appeal is that the ITAT is the final fact finding authority and hence, on factual issues, the matter has already reached finality in that year. However, if the ITAT has not decided the matter and has only set aside the order for fresh consideration of the matter by the lower authorities with full discretion at their disposal, the matter shall not be treated as one having reached finality and hence, benefit of rollback can still be given.

There is no mismatch between Rule 10MA(3) and Rule 10RA(4).

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Question 5

Rule 10MA(3)(ii) provides that rollback provision shall not be provided in respect of an international transaction for a rollback year if the application of rollback provision has the effect of reducing the total income or increasing the loss, as the case may be, of the applicant as declared in the return of income of the said year. It may be clarified whether the rollback provisions in such situations can be applied in a manner so as to ensure that the returned income or loss is accepted as the final income or loss after applying the rollback provisions.

Answer

It is clarified that in case the terms of rollback provisions contain specific agreement between the Board and the applicant that the agreed determination of ALP or the agreed manner of determination of ALP is subject to the condition that the ALP would get modified to the extent that it does not result in reducing the total income or increasing the total loss, as the case may be, of the applicant as declared in the return of income of the said year, the rollback provisions could be applied. For example, if the declared income is Rs. 100, the income as adjusted by the TPO is Rs. 120, and the application of the rollback provisions results in reducing the income to Rs. 90, then the rollback for that year would be determined in a manner that the declared income Rs. 100 would be treated as the final income for that year.

Question 6

Rule 10RA(7) states that in case effect cannot be given to the rollback provision of an agreement in accordance with this rule, for any rollback year to which it applies, on account of failure on the part of applicant, the agreement shall be cancelled. It is to be clarified as to whether the entire agreement is to be cancelled or only that year for which roll back fails.

Answer

The procedure for giving effect to a rollback provision is laid down in Rule 10RA. Sub-rules (2), (3), (4) and (6) of the Rule specify the actions to be taken by the applicant in order that effect may be given to the rollback provision. If the applicant does not carry out such actions for any of the rollback years, the entire agreement shall be cancelled.

This is because the rollback provision has been introduced for the benefit of the applicant and is applicable at its option. Accordingly, if the rollback provision cannot be given effect to for any of the rollback years on account of the applicant not taking the actions specified in sub- rules (2), (3), (4) or (6), the entire agreement gets vitiated and will have to be cancelled.

Question 7

If there is a Mutual Agreement Procedure (MAP) application already pending for a rollback year, what would be the stand of the APA authorities? Further, what would be the view of the APA Authorities, if MAP has already been concluded for a rollback year?

Answer

If MAP has been already concluded for any of the international transactions in any of the rollback year under APA, rollback provisions would not be allowed for those international transactions for that year but could be allowed for other years or for other international transactions for that year, subject to fulfilment of specified conditions in Rules 10MA and 10RA.

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However, if MAP request is pending for any of the rollback year under APA, upon the option exercised by the applicant, either MAP or application for roll back shall be proceeded with for such year.

Question 8

Rule 10MA(1) provides that the agreement may provide for determining ALP or manner of determination of ALP. However, Rule 10MA(4) only specifies that the manner of determination of ALP should be the same as in the APA term. Does that mean the ALP could be different?

Answer

Yes, the ALP could be different for different years. However, the manner of determination of ALP (including choice of Method, comparability analysis and Tested Party) would be same.

Question 9

Will there be compliance audit for roll back? Would critical assumptions have to be validated during compliance audit?

Answer

Since rollback provisions are for past years, ALP for the rollback years would be agreed after full examination of all the facts, including validation of critical assumptions. Hence, compliance audit for the rollback years would primarily be to check if the agreed price or methodology has been applied in the modified return.

Question 10

Whether applicant has an option to withdraw its rollback application? Can the applicant accept the rollback results without accepting the APA for the future years?

Answer

The applicant has an option to withdraw its roll back application even while maintaining the APA application for the future years. However, it is not possible to accept the rollback results without accepting the APA for the future years. It may also be noted that the fee specified in Rule 10MA(5) shall not be refunded even where a rollback application is withdrawn.

Question 11

For already concluded APAs, will new APAs be signed for rollback or earlier APAs could be revised?

Answer

The second proviso to Rule 10MA(5) provides for revision of APAs already concluded to include rollback provisions.

Question 12

For already concluded APAs, where the modified return has already been filed for the first year of the APA term, how will the time-limit for filing modified return for rollback years be determined?

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Answer

The time to file modified return for rollback years will start from the date of signing the revised APA incorporating the rollback provisions.

Question 13

In case of merger of companies, where one or more of those companies are APA applicants, how would the rollback provisions be allowed and to which company or companies would it be allowed?

Answer

The agreement is between the Board and a person. The principle to be followed in case of merger is that the person (company) who makes the APA application would only be entitled to enter into the agreement and be entitled for the rollback provisions in respect of international transactions undertaken by it in rollback years. Other persons (companies) who have merged with this person (company) would not be eligible for the rollback provisions.

To illustrate, if A, B and C merge to form C and C is the APA applicant, then the agreement can only be entered into with C and only C would be eligible for the rollback provisions. A and B would not be eligible for the rollback provisions. To illustrate further, if A and B merge to form a new company C and C is the APA applicant, then nobody would be eligible for rollback provisions.

Question 14

In case of a demerger of an APA applicant or signatory into two or more companies (persons), who would be eligible for the rollback provisions?

Answer

The same principle as mentioned in the previous answer, i.e., the person (company) who makes an APA application or enters into an APA would only be entitled for the rollback provisions, would continue to apply. To illustrate, if A has applied for or entered into an APA and, subsequently, demerges into A and B, then only A will be eligible for rollback for international transactions covered under the APA. As B was not in existence in rollback years, availing or grant of rollback to B does not arise.

Illustration 2

A Ltd., an Indian company, provides technical services to a company, XYZ Inc., located in a NJA for a consideration of Rs. 40 lakhs in October, 2017. It charges Rs. 42 lakhs for similar services rendered to PQR Inc., which is not located in a NJA. PQR Inc. is not an associated enterprise of A Ltd.

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.

Solution

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

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attracted in this case.

The price of Rs. 42 lakhs charged for similar services from PQR Inc, being an independent entity 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 the ALP is more than the transfer price, the ALP of Rs. 42 lakhs would be considered as the income arising from the international transaction between A Ltd. and XYZ Inc.

Illustration 3

Mr. X, a non-resident individual, is due to receive interest of Rs. 5 lakhs during March 2016 from a notified infrastructure debt fund eligible for exemption under section 10(47). He incurred expenditure amounting to Rs. 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.

Solution

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 Rs. 25,750 (being 5% of Rs. 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.

EXERCISE

Question 1

Examine the consequences that would follow if the Assessing Officer makes adjustment to arm's length price in international transactions of the assessee resulting in increase in taxable income. What are the remedies available to the assessee to dispute such adjustment?

Answer

In case the Assessing Officer makes adjustment to arm's length price in an international transaction which results in increase in taxable income of the assessee, the following consequences shall follow:-

(1) No deduction under section 10AA or Chapter VI-A shall be allowed from the income so increased.

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(2) No corresponding adjustment would be made to the total income of the other associated enterprise (in respect of payment made by the assessee from which tax has been deducted or is deductible at source) on account of increase in the total income of the assessee on the basis of the arm's length price so recomputed.

The remedies available to the assessee to dispute such an adjustment are:-

(1) In case the assessee is an eligible assessee under section 144C, he can file his objections to the variation made in the income within 30 days [of the receipt of draft order by him] to the Dispute Resolution Panel and Assessing Officer. Appeal against the order of the Assessing Officer in pursuance of the directions of the Dispute Resolution Panel can be made to the Income-tax Appellate Tribunal.

(2) In any other case, he can file an appeal under section 246A to the Commissioner (Appeals) against the order of the Assessing Officer within 30 days of the date of service of notice of demand.

(3) The assessee can opt to file an application for revision of order of the Assessing Officer under section 264 within one year from the date on which the order sought to be revised is communicated, provided the time limit for appeal to the Commissioner (Appeals) or the Income-tax Appellate Tribunal has expired or the assessee has waived the right of such an appeal. The eligibility conditions stipulated in section 264 should be fulfilled.

Question 2

I. Limited, an Indian Company supplied billets to its holding company, U. Limited, UK during the previous year 2017-18. I. Limited also supplied the same product to another UK based company, V. Limited, an unrelated entity. The transactions with U. Limited are priced at Euro 500 per MT (FOB), whereas the transactions with V. Limited are priced at Euro 700 per MT (CIF). Insurance and Freight amounts to Euro 200 per MT. Compute the arm's length price for the transaction with U. Limited.

Answer

In this case, I. Limited, the Indian company, supplied billets to its foreign holding company, U. Limited. Since the foreign company, U. Limited, is the holding company of I. Limited, I. Limited and U. Limited are the associated enterprises within the meaning of section 92A.

As I. Limited supplies similar product to an unrelated entity, V. Limited, UK, the transactions between I. Limited and V. Limited can be considered as comparable uncontrolled transactions for the purpose of determining the arm's length price of the transactions between I. Limited and U. Limited Comparable Uncontrolled Price (CUP) method of determination of arm's length price (ALP) would be applicable in this case.

Transactions with U. Limited are on FOB basis, whereas transactions with V. Limited are on CIF basis. This difference has to be adjusted before comparing the prices.

	Amount (in Euro)
Price per MT of billets to V. Limited	700
Less: Cost of insurance and freight per M.T.	200
Adjusted Price per M.T.	500

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Since the adjusted price for V. Limited, UK and the price fixed for U. Limited are the same, the arm's length price is Euro 500 per MT. Since the sale price to related party (i.e., U. Limited) and unrelated party (i.e., V. Limited) is the same, the transaction with related party U. Limited has also been carried out at arm's length price.

Question 3

X Ltd., operating in India, is the dealer for the goods manufactured by Yen Ltd. of Japan. Yen Ltd. owns 55% shares of X Ltd. and out of 7 directors of the company, 4 were appointed by them. The Assessing Officer, after verification of transactions of Rs. 300 lacs of X Ltd. for the relevant year and by noticing that the company had failed to maintain the requisite records and had also not obtained the accountants report, adjusted its income by making an addition of Rs. 30,00,000 to the declared income and also issued a show cause notice to levy various penalties. X Ltd seeks your expert opinion.

Answer

The facts of the case indicate that X Ltd. and Yen Ltd. of Japan are associated enterprises since Yen Ltd. holds 55% shares of X Ltd. and has appointed more than half of the board of directors of X Ltd. Since Yen Ltd. is a non-resident, any transaction between X Ltd. and Yen Ltd. would fall within the meaning of "international transaction" under section 92B. Therefore, the income arising from such transactions have to be computed having regard to the arm's length price.

The action of the Assessing Officer in making addition to the declared income and issuing show cause notice for levy of various penalties is correct since X Ltd. had committed defaults, as listed hereunder, in respect of which penalty, as briefed hereunder, is imposable -

(i) Failure to report any international transaction or any transaction, deemed to be an international transaction or any specified domestic transaction, to which the provisions of Chapter X applies, would attract penalty @ 200% of the amount of tax payable since it is a case of misreporting of income referred under section 270A(9) read with section 270A(8).

(ii) Failure to maintain the requisite records as required under section 92D in relation to international transaction makes it liable for penalty under section 271AA which will be 2% of the value of each international transaction.

(iii) Failure to furnish report from an accountant as required under section 92E makes it liable for penalty under section 271BA i.e., a fixed penalty of Rs. 1 Lac.

The Assessing Officer shall give an opportunity of hearing to the assessee with a notice as to why the arm's length price should not be determined on the basis of material or information or document in the possession of the Assessing Officer.

Note: It is assumed that X Ltd. has not entered into an APA and has also not opted to be subject to Safe Harbour Rules.

Question 4

Anush Motors Ltd., an Indian company declared income of Rs. 300 crores computed in accordance with Chapter IV-D but before making any adjustments in respect of the following transactions for the year ended on 31.3.2018:

(i) 10,000 cars sold to Rida Ltd. which holds 30% shares in Anush Motors Ltd. at a price which is

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less by $ 200 each car than the price charged from Shingto Ltd.

(ii) Royalty of $ 1,20,00,000 was paid to Kyoto Ltd. for use of technical know-how in the manufacturing of car. However, Kyoto Ltd. had provided the same know-how to another Indian company for $ 90,00,000.

(iii) Loan of Euro 1000 crores carrying interest @ 10% p.a. advanced by Dorf Ltd., a German company, was outstanding on 31.3.2018. The total book value of assets of Anush Motors Ltd. on the date was Rs. 90,000 crores. The said German company had also advanced a loan of similar amount to another Indian company @ 9% p.a. Total interest paid for the year was EURO 100 crores.

Explain in brief the provisions of the Act affecting all these transactions and compute the income of the company chargeable to tax for A.Y.2018-19 keeping in mind that the value of 1$ and of 1 EURO was Rs. 63 and Rs. 84, respectively, throughout the year.

Answer

Any income arising from an international transaction, where two or more "associated enterprises" enter into a mutual agreement or arrangement, shall be computed having regard to arm's length price as per the provisions of Chapter X of the Act.

Section 92A defines an "associated enterprise" and sub-section (2) of this section speaks of the situations when the two enterprises shall be deemed to associated enterprises. Applying the provisions of section 92A(2)(a) to (m) to the given facts, it is clear that "Anush Motors Ltd." is associated with :-

(i) Rida Ltd. as per section 92A(2)(a), because this company holds shares carrying more than 26% of the voting power in Anush Motors Ltd.;

(ii) Kyoto Ltd. as per section 92A(2)(g), since this company is the sole owner of the technology used by Anush Motors Ltd. in its manufacturing process;

(iii) Dorf Ltd. as per section 92A(2)(c), since this company has financed an amount which is more than 51% of the book value of total assets of Anush Motors Ltd.

The transactions entered into by Anush Motors Ltd. with different companies are, therefore, to be adjusted accordingly to work out the income chargeable to tax for the A.Y. 2018-19.

Particulars		` (in crores)
Income of Anush Motors Ltd. as computed under Chapter IV-D, prior to adjustments as per Chapter X		300.00
Add:	Difference on account of adjustment in the value of international transactions:	
(i)	Difference in price of car @ $ 200 each for 10,000 cars ($ 200 x 10,000 x ` 63)	12.60
(ii)	Difference for excess payment of royalty of $ 30,00,000 ($ 30,00,000 x ` 63) [See Note below]	18.90
(iii)	Difference for excess interest paid on loan of EURO 1000 crores (` 84*1000*1/100)	840.00
Total Income		**1,171.50**

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The difference for excess payment of royalty has been added back presuming that the manufacture of cars by Anush Motors Ltd is wholly dependent on the use of know-how owned by Kyoto Ltd.

Note: It is presumed that Anush Motors Ltd. has not entered into an Advance Pricing Agreement or opted to be subject to Safe Harbour Rules.

Question 5

What is the legislative objective of bringing into existence the provisions relating to transfer pricing in relation to international transactions? Examine.Answer

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.

Question 6

R, an individual resident in India, bought 1,000 equity shares of Rs. 10 each of A Ltd. at Rs. 50 per share on 30.5.2017. He sold 700 equity shares at Rs. 35 per share on 30.9.2017 and the remaining 300 shares at Rs. 25 per share on 20.12.2017. A Ltd. declared a dividend of 50%, the record date being 10.8.2017. R sold on 1.2.2018, a house from which he derived a long-term capital gain of Rs. 75,000.

Compute the amount of capital gain arising to R for the assessment year 2018-19.

Answer

The amount of capital gains arising to R has to be computed applying the provisions of sub-section (7) of section 94, which 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 -

  (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

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(c) the dividend or income on such securities or unit received or receivable by such person is exempted,

then the loss, if any, arising to him on account of such purchase and sale of securities or unit, to the extent such loss does not exceed the amount of dividend or income received or receivable on such securities or unit, shall be ignored for the purpose of computing his income chargeable to tax".

For this purpose, "record date" means such date as may be fixed by a company for the purpose of entitlement of the holder of the securities to receive dividend; "securities" includes stocks and shares.

Computation of capital gains of Mr. R for the assessment year 2018-19

Particulars	`	`
Long-term capital gain on sale of building		75,000
Less: Short-term capital loss on sale of shares		
700 shares	7,000	
300 shares	7,500	14,500
Taxable long-term capital gains		**60,500**

Computation of capital gain on sale of shares of A Ltd. by Mr. R

Date of purchase of shares		30.5.2017
Record date		10.8.2017
Date of sale of shares	30.9.2017	20.12.2017
Number of shares sold	700	300
Sale price per share	` 35	` 25

Particulars	`	`
Sale consideration	24,500	7,500
Less: Cost of acquisition	35,000	15,000
	10,500	7,500
Less: Dividend income as per section 94(7)[700×` 10×50%] [See Note below]	3,500	-
Short-term capital loss on sale of shares	**7,000**	**7,500**

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Note:

(1) 700 shares are sold within 3 months after the record date. Hence, as per section 94(7), the related dividend income should be deducted from the loss.

(2) 300 shares having been sold after 3 months of record date, section 94(7) is not attracted. Therefore, the dividend income of Rs. 1,500 [300×Rs. 10×50%] should not be deducted. Such dividend is exempt under section 10(34).

(3) Short-term capital loss can be set-off against long-term capital gains as per the provisions of section 74(1)(a). Therefore, short-term capital loss on sale of shares can be set-off against long-term capital gains on sale of building.

Question 7

XE Ltd. is an Indian Company in which Zilla Inc., a US company, has 28% shareholding and voting power. Following transactions were effected between these two companies during the financial year 2017-18.

(i) XE Ltd. sold 1,00,000 pieces of T-shirts at $ 2 per T-Shirt to Zilla Inc. The identical T-Shirts were sold to unrelated party namely Kennedy Inc., at $ 3 per T-Shirt.

(ii) XE Ltd. borrowed $ 2,00,000 from a foreign lender based on the guarantee of Zilla Inc. For this, XE Ltd. paid $ 10,000 as guarantee fee to Zilla Inc. To an unrelated party for the same amount of loan, Zilla Inc. collected $ 7000 as guarantee fee.

(iii) XE Ltd. paid $15,000 to Zilla Inc. for getting various potential customers details to improve its business. Zilla Inc. provided the same service to unrelated parties for $ 10,000.

Assume the rate of exchange as 1 $ = Rs. 64

XE Ltd. is located in a Special Economic (SEZ) and its income before transfer pricing adjustments for the year ended 31st March, 2018 was Rs. 1,200 lakhs.

Compute the adjustments to be made to the total income of XE Ltd. State whether it can claim deduction under section 10AA for the income enhanced by applying transfer pricing provisions.

Answer

XE Ltd, the Indian company and Zilla Inc., the US company are deemed to be associated enterprises as per section 92A(2)(a), since Zilla Inc. holds shares carrying not less than 26% of the voting power in XE Ltd.

As per Explanation to section 92B, the transactions entered into between these two companies for sale of product, lending or guarantee and provision of services relating to market research are included within the meaning of "international transaction".

Accordingly, transfer pricing provisions would be attracted and the income arising from such international transactions have to be computed having regard to the arm's length price. In this case, from the information given, the arm's length price has to be determined taking the

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comparable uncontrolled price method to be the most appropriate method.

Particulars		Rs. in lakhs
Amount by which total income of XE Ltd. is enhanced on account of adjustment in the value of international transactions:		
(i)	Difference in price of T-Shirt @ $ 1 each for 1,00,000 pieces sold to Zilla Inc. ($ 1 x 1,00,000 x Rs. 64)	64.00
(ii)	Difference for excess payment of guarantee fee to Zilla Inc. for loan borrowed from foreign lender ($ 3,000 x Rs. 64)	1.92
(iii)	Difference for excess payment for services to Zilla Inc. ($ 5,000 x Rs. 64)	3.20
		69.12
XE Ltd. cannot claim deduction under section 10AA in respect of Rs. 69.12 lakhs, being the amount of income by which the total income is enhanced by virtue of the first proviso to section 92C(4)		

Question 8

Examine the correctness or otherwise of the following with reference to the provisions of the Income-tax Act, 1961

(i) Transfer pricing rules shall have no implication where income is computed on the basis of book profits.

(ii) Assessing Officer can complete the assessment of income from international transaction in disregard of the order passed by the Transfer Pricing Officer by accepting the contention of assessee.

Answer

(i) The statement is correct.

For the purpose of computing book profit for levy of minimum alternate tax, the net profit shown in the profit and loss account prepared in accordance with the Companies Act can be increased/decreased only by the additions and deductions specified in Explanation 1 to section 115JB.

No other adjustments can be made to arrive at the book profit for levy of MAT, except where:

(a) it is discovered that the profit and loss account is not drawn up in accordance with the relevant Schedule of the Companies Act

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(b) incorrect accounting policies and/or accounting standards have been adopted for preparing such accounts; and

(c) the method and rate of depreciation adopted is not correct.

Therefore, transfer pricing adjustments cannot be made while computing book profit for levy of MAT.

(ii) The statement is <u>not</u> correct.

Section 92CA(4) provides that on receipt of the order of the Transfer Pricing Officer determining the arm's length price of an international transaction, the Assessing Officer shall proceed to compute the total income in conformity with the arm's length price determined by the Transfer Pricing Officer.

The order of the Transfer Pricing Officer is binding on the Assessing Officer. Therefore, the Assessing Officer cannot complete the assessment of income from international transactions in disregard of the order of Transfer Pricing Officer by accepting the contention raised by the assessee.

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EXERCISE

Question 1

Examine whether a person resident in India can seek advance ruling from the Authority for Advance Ruling.

Answer

A resident can make an application to the Authority for Advance Ruling to seek an advance ruling in the following cases:

(i) Section 245N(b)(A)(III) enables a resident referred in section 245N(a)(iia) falling within any such class or category of persons as may be notified by the Central Government to make an application to Authority for Advance Rulings. Such notified resident applicant can seek ruling in relation to his tax liability arising out of a transaction which has been undertaken or is proposed to be undertaken by **such applicant**, and such determination shall include the determination of any question of law or of fact specified in the application.

A resident in relation to his tax liability arising out of one or more transactions valuing ` 100 crore or more in total which has been undertaken or proposed to be undertaken would be an applicant for this purpose.

(ii) Section 245N(b)(A)(IV) enables a resident falling within any such class or category of persons as may be notified by the Central Government to make an application for Advance Ruling. Such notified resident applicant can seek ruling in respect of issues relating to computation of total income which is pending before any income-tax authority or the Appellate Tribunal. Such a resident applicant can make an application to seek determination or decision by the AAR on a question of law or a question of fact relating to such computation of total income specified in the application.

"Public sector companies" as defined in section 2(36A) of the Income -tax Act, 1961 have been notified as applicant for this purpose.

(iii) A resident can also make an application seeking advance ruling in relation to the tax liability of a non-resident arising out of a transaction undertaken or proposed to be undertaken by him with such non-resident.

Question 2

Q, a non-resident, made an application to the Authority for Advance Rulings on 2.7.2017 in relation to a transaction proposed to be undertaken by him. On 31.8.2017, he decides to withdraw the said application. Can he withdraw the application on 31.8.2017?

Answer

Section 245Q(3) of the Income-tax Act, 1961 provides that an applicant, who has sought for an advance ruling, may withdraw the application within 30 days from the date of the application. Since more than 30 days have elapsed since the date of application by Q to the Authority for

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Advance Rulings, he cannot withdraw the application.

However, the Authority for Advance Rulings (AAR), in M.K.Jain AAR No.644 of 2004, has observed that though section 245Q(3) provides that an application may be withdrawn by the applicant within 30 days from the date of the application, this, however, does not preclude the AAR from permitting withdrawal of the application after the said period with the permission of the AAR, if the circumstances of the case so justify.

Question 3

Examine when can an advance ruling pronounced by the Authority for Advance Rulings be declared void. What is the consequence?

Answer

As per section 245T, an advance ruling can be declared to be void ab initio by the Authority for Advance Rulings if, on a representation made to it by the Principal Commissioner or Commissioner or otherwise, it finds that the ruling has been obtained by fraud or misrepresentation of facts. Thereafter, all the provisions of the Act will apply as if no such advance ruling has been made. A copy of such order shall be sent to the applicant and the Principal Commissioner or Commissioner.

Question 4

Mr. Balram is a non-resident. The appeal pertaining to the assessment year 2013-14 is pending before the Income-tax Appellate Tribunal, the issue involved being computation of export profit and tax thereon. The same issue persists for the assessment year 2014 -15 as well. Mr. Balram's brother Mr. Krishna has obtained an advance ruling under Chapter XIX - B of Income-tax Act, 1961 from the Authority for Advance Ruling on an identical issue. Mr. Balram proposes to use the said ruling for his assessment pertaining to the assessment year 2014-15. Can he do so?

Answer

As per section 245S(1), the advance ruling pronounced under section 245R by the Authority for Advance Rulings shall be binding only on the applicant who had sought it and in respect of the specific transaction in relation to which advance ruling was sought. It shall also be binding on the Principal Commissioner/Commissioner and the income-tax authorities subordinate to him, in respect of the concerned applicant and the specific transaction.

In view of the above provision, Mr. Balram cannot use the advance ruling, obtained on an identical issue by his brother, for his assessment pertaining to the assessment year 20 14-15.

Note – Though the ruling of the Authority for Advance Rulings is not binding on others but there is no bar on the Tribunal taking a view or forming an opinion in consonance with the reasoning of the Authority for Advance Rulings de hors the binding nature [CIT v. P. Sekar Trust (2010) 321 ITR 305 (Mad.)].

Question 5

The Authority for Advance Rulings has the powers of compelling the production of books of account– Examine the correctness or otherwise of this statement.

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Answer

The statement is correct.

Under section 245U, the Authority for Advance Rulings shall have all the powers vested in the Civil Court under the Code of Civil Procedure, 1908 as are referred to in section 131.

Accordingly, the Authority for Advance Rulings shall have the same powers as are vested in a court under the Code of Civil Procedure, 1908, when trying a suit in respect of the following matters, namely -

(1) discovery and inspection;

(2) enforcing the attendance of any person, including any officer of a banking company and examining him on oath;

(3) compelling the production of books of account and other documents; and

(4) issuing commissions.

Therefore, the Authority for Advance Ruling has the powers of compelling the production of books of account.

Question 6

The term 'Advance Ruling' includes within its scope, a determination by the Authority for Advance Rulings only in relation to a transaction undertaken by a non-resident application. Examine the correctness of this statement, with reference to the provisions of the Income-tax Act 1961.

Answer

The statement is not correct.

The term 'Advance Ruling' has been defined in section 245N(a) to mean : -

(a) 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**; or

(b) 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**; or

(c) a determination by the Authority in relation to the tax liability of a **resident applicant**, arising out of a transaction which has been undertaken or is proposed to be undertaken by **such applicant**, and such determination shall include the determination of any question of law or of fact specified in the application

A resident in relation to his tax liability arising out of one or more transactions valuing ` 100 crore or more in total which has been undertaken or proposed to be undertaken would be an applicant for this purpose.

(d) 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

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such determination or decision shall include the determination or decision on any question of law or of fact relating to such computation of total income specified in the application.

Question 7

A foreign company entered into contracts with several Indian companies for installation o f mobile telephone system and made an application to the Authority for Advance Rulings for advance ruling on the rate of withholding tax on receipts from Indian companies. One of the Indian companies had also made an application to the Assessing Officer for determination of the rate at which tax is deductible on payment to the said foreign company. The Authority for Advance Rulings rejected the application of the foreign company on the ground that the question raised in the application is already pending before an income tax authority. Is the rejection of the application of the foreign company justified in law?

Answer

The matter relates to the admission or rejection of the application filed before the Advance Ruling s Authority on the grounds specified in clause (i) of the first proviso to sub-section (2) of section 245R of the Income-tax Act, 1961.

Clause (i) of the first proviso of section 245R(2) provides that the Authority shall not allow the application where the question raised in the application is already pending before any income-tax authority or Appellate Tribunal or any court. (except in case of resident falling in sub -clause (iii) of clause (b) of section 245N)

In the above case, no application had been filed or contention urged by the applican t (foreign company) before any income-tax authority/Appellate Tribunal/court, raising the question raised in the application filed with AAR. One of the Indian companies, however, had raised the question before the Assessing Officer, not on the applicant's behalf or with a view to benefit the applicant, but only to safeguard its own interest, as it had a statutory duty to deduct the proper amount of tax from payments made to a non-resident. Although the question raised pertains to one of the payments made or to be made to the non-resident applicant, it was not one pending determination before any income-tax authority in the applicant's case.

Therefore, as held by the AAR in Ericsson Telephone Corporation India AB v. CIT (1997) 224 ITR 203, the application filed by the Indian company before the Assessing Officer cannot be treated to have been filed by the non-resident. Hence, it would not be proper to reject the application of the foreign company relying on clause (i) of the proviso to sub-section (2) of section 245R of the Income-tax Act, 1961.

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Question 1

Explain the core reasons for difference between the e-commerce transactions and the traditional business transactions causing difficulty to tax the income of e-commerce transactions.

Answer

The core reasons for difference between e-commerce transactions and traditional business transactions causing difficulty to tax the income from e-commerce transactions under the Income- tax Act, 1961 are absence of national boundaries, no requirement of physical presence of goods and no requirement of physical delivery (in certain cases). Since e-commerce transactions are completed in cyberspace, it is often not clear as to the place where the transaction is effected, thereby causing difficulty in implementing source rule taxation.

Question 2

E-commerce transactions have replaced concepts generally associated with international transactions traditionally. Discuss briefly the issues involving such transactions.

Answer

The typical taxation issues relating to e-commerce are:

(1) the difficulty in characterizing the nature of payment and establishing a nexus or link between taxable transaction, activity and a taxing jurisdiction,

(2) the difficulty of locating the transaction, activity and identifying the taxpayer for income tax purposes.

Question 3

ABC Ltd., an Indian company, is carrying on the business of manufacture and sale of teakwood furniture under the brand name "PUREWOOD". In order to expand its overseas sales/exports, it launched a massive advertisement campaign of its products. For the purpose of online advertisement, it utilized the services of PQR Inc., a London based company. During the previous year 2017-18, ABC Ltd. paid ` 5 lakhs to PQR Inc. for such services. Discuss the tax implications/TDS implications of such payment and receipt in the hands of ABC Ltd. and PQR Inc., respectively, if –

(i) PQR Inc. has no permanent establishment in India

(ii) PQR Inc. has a permanent establishment in India

Answer

Chapter VIII of the Finance Act, 2016, "Equalisation Levy", provides for an equalisation levy of 6% of the amount of consideration for specified services received or receivable by a non-resident not having permanent establishment in India, from a resident in India who carries out business or profession, or from a non-resident having permanent establishment in India.

"Specified Service" means

(1) online advertisement;

(2) any provision for digital advertising space or any other facility or service for the purpose of online advertisement and

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(3) Any other service as may be notified by the Central Government.

However, equalisation levy shall not be levied-

- where the non-resident providing the specified services has a permanent establishment in India
- the aggregate amount of consideration for specified service received or receivable during the previous year does not exceed ` 1 lakh.
- where the payment for specified service is not for the purposes of carrying out business or profession

(i) Where PQR Inc. has no permanent establishment in India

In the present case, ABC Ltd. is required to deduct equalisation levy of ` 30,000 i.e., @6% of ` 5 lakhs, being the amount paid towards online advertisement services provided by PQR Inc., a non-resident having no permanent establishment in India. Non-deduction of equalisation levy would attract disallowance under section 40(a)(ib) of 100% of the amount paid while computing business income.

(ii) Where PQR Inc. has permanent establishment in India

Equalisation levy would not be attracted where the non-resident service provider (PQR Inc., in this case) has a permanent establishment in India. Therefore, the ABC Ltd. is not required to deduct equalisation levy on `5 lakhs, being the amount paid towards online advertisement services to PQR Inc, in this case.

However, tax has to be deducted by ABC Ltd. at the rates in force under section 195 in respect of such payment to PQR Inc. Non-deduction of tax at source under section 195 would attract disallowance under section 40(a)(i) of 100% of the amount paid while computing business income.

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