

DIRECT **TAXES**



POWER PACK REVISION MATERIAL

RELEVANT FOR MAY 2019 EXAM

- CA MEHUL THAKKER

POWER PACK REVISION MATERIAL

FOR MAY 2019

CA MEHUL THAKKER

ASSESSMENT YEAR 2019-20

Special Thanks to CA Chetan V Chaudhary

Law stated in this book is as amended by the Finance Act, 2018

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A MILLION TON QUESTION

WHAT TO REVISE IN DIRECT TAX

ON LAST DAY?

IF YOU FIND

- ✓ **ALL AMENDMENTS MADE BY FA 2018**
- ✓ **RECENT CIRCULARS**
- ✓ **RECENT NOTIFICATIONS**
- ✓ **FREQUENTLY ASKED PRACTICALS**
- ✓ **IMPORTANT CASE STUDIES**
- ✓ **RTP MAY 2019**

AT ONE PLACE





**HERE IS THE
POWER PACK
REVISION
MATERIAL**

PART – I

IMPORTANT PROVISIONS

OF INCOME TAX ACT, 1961

1 – BASICS OF INCOME TAX

1.1 RATES OF INCOME TAX

(1) Individual/ HUF/ AOP / BOI and every artificial juridical person

Level of Total Income	Rate of income-tax
Where the total income	
- Does not exceed Rs. 2,50,000	Nil
- Exceeds Rs. 2,50,000 but does not exceed Rs. 5,00,000	5% of the amount by which the total income exceeds Rs. 2,50,000
- Exceeds Rs. 5,00,000 but does not exceed Rs. 10,00,000	Rs. 12,500 plus 20% of the amount by which the total income exceeds Rs. 5,00,000
- Exceeds Rs. 10,00,000	Rs. 1,12,500 plus 30% of the amount by which the total income exceeds Rs. 10,00,000

(2) For resident individuals of the age of 60 years or more but less than 80 years at any time during the previous year.

Level of total income	Rate of income-tax
Where the total income	
- Does not exceed Rs. 3,00,000	Nil
- Exceeds Rs. 3,00,000 but does not exceed Rs. 5,00,000	5% of the amount by which the total income exceeds Rs. 3,00,000
- Exceeds Rs. 5,00,000 but does not exceed Rs. 10,00,000	Rs. 10,000 plus 20% of the amount by which the total income exceeds Rs. 5,00,000
- Exceeds Rs. 10,00,000	Rs. 1,10,000 plus 30% of the amount by which the total income exceeds Rs. 10,00,000

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

Level of total income	Rate of income-tax
Where the total income	
- Does not exceed Rs. 5,00,000	Nil
- Exceeds Rs. 5,00,000 but does not exceed Rs. 10,00,000	20% of the amount by which the total income exceeds Rs. 5,00,000
- Exceeds Rs. 10,00,000	Rs. 1,00,000 plus 30% of the amount by which the total income exceeds Rs. 10,00,000

(4) Circular No. 28/2016, dated 27-07-2016

Clarification regarding attaining prescribed age of 60 years/80 years on 31st March itself, in case of senior/very senior citizens whose date of birth falls on 1st April

- The Supreme Court in the case of *Prabhu Dayal Sesma vs. State of Rajasthan & another* 1986, AIR, 1948 observed that while counting the age of the person, whole of the day should be reckoned and it starts from 12 o'clock in the midnight and he attains the specified age on the day preceding, the anniversary of his birthday.

- The CBDT has, vide this Circular, clarified that a person born on 1st April would be considered to have attained a particular age on 31st March, the day preceding the anniversary of his birthday.
- Therefore, a resident individual whose 60th birthday / 80th birthday falls on 1st April, 2019, would be treated as having attained the age of 60 years in the P.Y.2018-19, and would be eligible for higher basic exemption limit of Rs. 3 lakh/Rs. 5 lakh in computing his tax liability for A.Y.2019-20.

1.2 SURCHARGE AND MARGINAL RELIEF

The rates of surcharge applicable for A.Y. 2019-20 are as follows –

Surcharge (as a percentage of income tax)-	If total income is	If total income is in the range of	If total income is
	Upto Rs.50 lakhs	Rs.50 lakhs to Rs.1 crore	Above Rs.1 crore
Individuals/HUF/AOP/BOI/artificial juridical person	Nil	10%	15%

The above surcharge is subject to a Marginal relief

Why there is a need for marginal relief?

Consider Example (A) and (B)

Example : (A) Taxpayer : Mr. Active, 54 years having total income of Rs.50,00,000.

Particulars	Rs.
Tax on Rs.50,00,000	13,12,500
Add: Surcharge	Nil
Sub-total	13,12,500

Example : (B) Taxpayer: Mr. Passive, 55 years having total income of Rs.50,50,000.

Particulars	Rs.
Tax on Rs.50,50,000	13,27,500
Add: Surcharge (10%)	1,32,750
Sub-total	14,60,250

Now, as compared to Example (A), in Example (B), income is increased by **Rs. 50,000**, while tax is increased by **Rs.1,47,750**, therefore, there is a need for marginal relief.

Under marginal relief, **tax liability of Rs. 50,50,000 is restricted as under:-**

$$\begin{aligned}
 \text{Tax on 50,50,000} &= \text{Tax on 50,00,000} + (\text{Total Income} - \text{Rs.50,00,000}) \\
 &= \text{Tax on 50,00,000} + (50,50,000 - \text{Rs.50,00,000}) \\
 &= 13,12,500 + 50,000 \\
 &= 13,62,500
 \end{aligned}$$

The above tax is increased by health and education cess

☺ EASY STEPS to compute Final tax liability when total income of Individual ranges between Rs.50,00,001 to Rs. 1,00,00,000.

Step 1: Find out regular tax liability + Surcharge (Ignore education cess)

Step 2: Find out tax on 50,00,000 + (Total Income-50,00,000)

Step 3: Step 1 or Step 2 whichever is lower

Step 4: Add Health and Education Cess

Practical 1

Find out tax payable of Mr. Jayesh, 51 years, having total income of Rs. 51,00,000.

1.3 HEALTH AND EDUCATION CESS (HEC)

“Health and Education cess (HEC)” is to be calculated at the rate of 4% of income-tax and surcharge. HEC is applicable to all assessees i.e., individuals, HUFs, AOP/BOIs, co-operative societies, firms, LLPs, local authorities and companies. The format of computation of HEC is as under:-

(a) Income Tax	XXXXXX
(b) Add: Surcharge on Income Tax (if any)	XXXXXX
(c) Sub-Total (a+b)	XXXXXX
(d) Health and Education cess @ 4% on (c)	XXXXXX
(e) Total Tax payable (c+d)	XXXXXX

No marginal relief would be available in respect of such cess.

2 – INCOME WHICH DO NOT FORM PART OF TOTAL INCOME

2.1 ROYALTY/FEES FOR TECHNICAL SERVICES BY NATIONAL TECHNICAL RESEARCH ORGANISATION (NTRO) TO NON-RESIDENT

Section:- 10(6D) - Effective from A.Y.2019-20

Sec.	Eligible Assessee	Nature of Income	Conditions/Definitions/Comments
10(6D)	Non-resident / Foreign Company	<i>Royalty/fees for technical services</i>	Such royalty is received from, or fees for technical services rendered in or outside India to National Technical Research Organisation (NTRO)

2.2 TAX-FREE WITHDRAWAL FROM NPS TO SELF-EMPLOYED

Section:- 10(12A) - Effective from A.Y.2019-20

Sec.	Eligible Assessee	Nature of Income	Conditions/Definitions/Comments
10(12A)	Employee Assessee	<i>40% of total amount payable to him is exempt.</i>	(1) Such amount is payable to employee at the time of closure of his account under NPS or opting out of the pension scheme referred to in section 80CCD. (2) If above amount has been received by nominee on death, then as per proviso to 80CCD (3), nothing shall be taxed in the hands of nominee.
10(12B)	Employee	Any payment from NPS to an employee on partial withdrawal	(1) Withdrawal is made in accordance with the terms and conditions, specified under the Pension Fund Regulatory and Development Authority Act, 2013 and (2) <i>Exemption shall not exceed twenty-five percent of the amount of contributions made by him.</i>

Practical 1

Mr. Suresh, an employee of ECO POWER LTD contributed Rs.5,00,000 to New Pension System (NPS) since few years and claimed deduction under section 80CCD. Mr. Suresh was in need of money and therefore, planning to make partial withdrawal of Rs. 2,00,000 from the contribution made by him. Discuss taxability, if any. What would have been your answer if he decided to opt out of NPS and received Rs. 11,00,000?

Practical 2

Suppose in the above problem, Mr. Suresh is a self-employed person. Discuss taxability, if any, under both the possibilities i.e. partial withdrawal and opting out of the scheme.

2.3 DISALLOWANCE PROVISIONS UNDER SECTION 40(a)(ia), 40A(3) & DEEMED INCOME UNDER SECTION 40A(3A) MADE APPLICABLE TO CERTAIN ENTITIES

Section:- 10(23C) - Effective from A.Y.2019-20

Sec.	Eligible Assessee	Nature of Income	Conditions/Definitions/Comments
10(23C)	<i>Income received by any person on behalf of following entities</i> (a) Prime Minister's National Relief fund. (b) Prime Minister's fund for promotion of folk art (c) Prime Minister's Aid to Students Fund (d) National foundation for communal harmony (e) Swachh Bharat Kosh Clean Ganga Fund (f) Chief Minister's Relief Fund or Lieutenant Governor's Relief Fund (g) University or other Educational Institution wholly or substantially financed by the Government	Any income	- The fund, trust, university, hospitals, charitable organization requiring approvals shall make an application in prescribed form to prescribed authority for the grant of or continuation of exemption. - Exemption shall not be available for anonymous donations referred to in section 115BBC. - The provisions of section 11, 12 or 12AA shall also apply to various institutions referred to herein. - The institutions where their income exceeds the maximum amount chargeable to tax shall get their accounts audited. - In case of other charitable trusts, universities, hospitals, charitable organization approved by specified authority in which case 1st proviso to Sec.2(15) applies exemption under this sec. shall not be allowed. - Where any income is required to be applied (or accumulated or set apart for application), then, for such purposes the income shall be determined without any deduction or allowance by way of depreciation (or otherwise) in respect of any asset, acquisition of which has been claimed as an application of income under section 10(23) in the same or any other previous year. For Entities mentioned at (h) and (i) Any university or other educational institution, hospital or other institution referred therein, shall be considered as being substantially financed by the Government for any previous year, if the Government grant to such university or other educational institution, hospital or other institution exceeds such percentage of the total receipts including any voluntary contributions, as may be prescribed (50% prescribed), of such university or other educational institution, hospital or other institution, as the case may be, during the relevant previous year.

Sec.	Eligible Assessee	Nature of Income	Conditions/Definitions/Comments
10(23C)	(h) Hospital or other institution wholly or substantially financed by Central govt. for treatment of specified illness and established for philanthropic purpose only. (i) University or educational institution set up for education purpose and not for profit and whose gross receipt does not exceed Rs.1 crore. (j) Hospital or other institution set up for philanthropic purpose for treatment of specified illness and whose gross receipts do not exceed Rs. 1 crore. (k) Other charitable trusts, universities, hospitals, charitable organization approved by specified authority	Any income	• For Entities mentioned at (l) - Entities which have been approved or notified for claiming benefit of exemption u/s 10(23) would not be entitled to claim any benefit of exemption under other provisions of section 10 (except the exemption in respect of agricultural income). - With effect from Assessment Year 2018-19, any donation (contribution) given to a trust or institution with a specific direction that they shall form part of the corpus of recipient trust or institution, then it shall not be treated as application of income for the donor trust or institution falling under point no. (l). - With effect from Assessment Year 2019-20, For the purpose of determining application of income, the provisions of section 40(a)(ia) and 40A(3)(3A), shall, mutatis mutandis, apply as they apply in computing the income chargeable under the head "Profits and gains of business or profession". [Amendment by Finance Act, 2018]

2.4 EXEMPTION FROM LONG-TERM CAPITAL GAINS SCHEME MODIFIED

Section:- 10(38) - Effective from A.Y.2019-20

Nothing contained in this clause shall apply to any income arising from the transfer of long term capital asset, being an equity share in a company or unit of an equity oriented fund or unit of a business trust, made on or after the 1st day of April, 2018.

2.5 SCOPE OF EXEMPTION ENLARGED IN CASE OF A FOREIGN COMPANY ON SALE OF LEFTOVER STOCK OF CRUDE OIL EVEN ON TERMINATION OF AGREEMENT OR ARRANGEMENT

Section:- 10(48B) - Effective from A.Y.2019-20

Sec.	Eligible Assessee	Nature of Income	Conditions/Definitions/Comments
10(48)	Foreign Company	Income received on account of sale of crude oil, any other goods or rendering of services as may be notified by Central Government in this behalf	(i) Income is received in India in Indian currency. (ii) Receipt of such income in India by the foreign company is pursuant to an agreement/arrangement entered into by the Central Government or approved by the Central Government. (iii) The foreign company and the agreement/arrangement are notified by the Central Government in this behalf. <i>[Name of Notified company is:- National Iranian Oil Company]</i>
10(48A)	Foreign Company	Any income accruing or arising on account of storage of crude oil in a facility in India and sale of crude oil therefrom to any person resident in India.	1. Storage and sale by the foreign company in pursuant to an agreement or arrangement entered into by the Central Government or approved by the Central Government. 2. Further, such agreement and foreign company is notified by the Central Government.
10(48B)	Foreign Company	Any income accruing or arising on account of sale of leftover stock of crude oil from the facility in India after the expiry of the agreement or arrangement or on the termination of the agreement or arrangement u/s 10(48A). (Amended by Finance Act, 2018 w.e.f. A.Y. 2019-20)	This exemption is subject to such conditions as Central Government may notify in this behalf.

2.6 SPECIAL PROVISIONS IN RESPECT OF NEWLY ESTABLISHED UNITS IN SPECIAL ECONOMIC ZONES

Section:- 10AA

(A) Conditions:

- (1) *A unit in SEZ has begun to manufacture or produce any article or things or provide any services after 31.03.2005 but on or before 31st March, 2020.*
- (2) *The unit in SEZ is not formed by the splitting up, or the reconstruction, of a business already in existence.*
However, where an industrial undertaking is formed as a result of re-establishment, reconstruction or revival by the assessee of the business of any such industrial undertaking as is referred to in section 33B, in the circumstances and within the period specified in that section the same will qualify for the tax concession.

Section 33B

The business of any industrial undertaking carried on in India is discontinued in any previous year by reason of extensive damage to, or destruction of, any building, machinery, plant or furniture owned by the assessee and used for the purposes of such business as a direct result of—

- (i) flood, typhoon, hurricane, cyclone, earthquake or other convulsion of nature ; or
- (ii) riot or civil disturbance ; or
- (iii) accidental fire or explosion ; or
- (iv) action by an enemy or action taken in combating an enemy (whether with or without a declaration of war),

and, thereafter, at any time before the expiry of three years from the end of such previous year, the business is re-established, reconstructed or revived by the assessee.

- (3) *The unit in SEZ is not set up by the transfer of plant and machinery previously used for any purpose.* This condition is subject to following relaxation:
 - (a) 20 per cent previously used plant and machinery is permitted - If the value of the previously used plant and machinery does not exceed 20 per cent of the total value of the machinery or plant used in the business, this condition is deemed to have been complied with.
 - (b) Second-hand imported machinery is treated as new- Any machinery or plant which was used outside India by any person other than the assessee shall not be regarded as machinery or plant previously used for any purpose, if the following conditions are fulfilled—
 - (i) Such machinery or plant was not, at any time previous to the date of the installation by the assessee, used in India.
 - (ii) Such machinery or plant is imported into India from any country outside India.
 - (iii) No deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under the Act in computing the total income of any person for any period prior to the date of the installation of the machinery or plant by the assessee.
- (4) The assessee shall furnish the *report from a chartered accountant* in a prescribed form along with the return of income, certifying that the deduction has been correctly claimed in accordance with the provision of this section.
- (5) *Deduction under section 10AA is not available unless it is claimed in the return of income.* – Section 80A(5).
- (6) *If deduction is claimed in respect of a specified business [as referred to in section 35AD(8)(c)] under section 10AA, no deduction in respect of that business will be available under section 35AD.*

(B) Period and quantum of deduction: -

<i>First 5 consecutive assessment years</i> (beginning with the assessment year in which undertaking begins to manufacture or produce articles or things or computer software, as the case may be)	100% of profits and gains derived from export
<i>Next 5 assessment years</i>	50% of profits and gains derived from export
<i>Next 5 assessment years</i>	50% of profits and gains derived from export or amount transferred to “Special Economic Zone Reinvestment Allowance Reserve Account” whichever is lower.

(C) Manner of utilization of “Special Economic Zone Reinvestment Allowance Reserve Account”.

- (1) The new plant and machinery shall be first put to use before the expiry of 3 years from the end of year in which the reserve was created.
- (2) Until the acquisition of new plant and machinery, the reserve may be utilized for the business purposes of the unit. However, it cannot be utilized for the distribution of dividends or profits or for remittance outside India as profits or for creating any asset outside India.
- (3) Prescribed particulars shall be submitted in respect of new plant and machinery along with the return of income for the previous year in which such plant and machinery was first put to use.
- (4) If the reserve is misutilized then the deduction shall be taken back in the year in which the reserve is misutilized and chargeable to tax in that year.
- (5) If the reserve is not utilized for acquiring new plant and machinery within three years as stated above then the deduction shall be taken back in the year immediately following the period of three years.

(D) Profits and gains derived from export shall be worked out as under: -

Profits of the business of the unit $\times \frac{\text{Export turnover of the unit}}{\text{Total Turnover of the unit}}$

- *Export Turnover* means the *consideration* in respect of export by the unit of articles or things or services *received* in, or brought into India by the assessee, *but does not include the following*:
 - a. Freight;
 - b. Telecommunication charges;
 - c. Insurance attributable to the delivery of the articles or things outside India;
 - d. Expenses, if any, incurred in foreign exchange in rendering of services outside India.
- The *profits and gains derived from on-site development* of computer software including services for development of software outside India *shall be deemed to be export profits* eligible for deduction.

(E) Ceiling on deduction to be claimed under section 10AA of the Act

- (a) *Amount of deduction under section 10AA shall be allowed from the total income* of the assessee computed under the Act *before giving deduction under section 10AA* and
- (b) *Deduction under section 10AA shall not exceed (a) above.*

(F) Power of A.O. to re-compute Profit

The provisions of 80IA(8) and 80IA(10) shall apply mutatis mutandis to the unit of SEZ claiming benefit under this section.

(G) Impact once benefit has been availed under section 10AA

- During the period of deduction, depreciation is deemed to have been allowed on the assets. Written down value shall be accordingly reduced.
- No deduction u/s. 80 IA or 80-IB shall be allowed in relation to the profits and gains of unit of SEZ.

DIVISION A-BASICS, RESIDENTIAL STATUS, EXEMPT INCOME 2 – INCOME WHICH DO NOT FORM PART OF...

- Any unabsorbed depreciation u/s.32(2); or business loss u/s.72 (1) or loss under the head 'Capital gains' u/s.74 of the unit shall not be allowed to be carried forward and set off where such loss relates to any of the assessment years ending before the 1st day of April, 2006.

(H) Impact when amalgamation or demerger takes place: -

Where an undertaking is transferred to another company under a scheme of amalgamation or demerger, the deduction under this section shall be allowable in the hands of the amalgamated or the resulting company for the unexpired period.

However, no deduction shall be admissible under this section to the amalgamating company or demerged company for the previous year in which amalgamation or demerger takes place.

Practical 3

Rajesh Exports Pvt Ltd. has set up its manufacturing unit in SEZ which is eligible for the benefit under section 10AA of Income Tax Act. Apart from that it has another manufacturing unit in Non-SEZ area. It provides following information for the year under consideration:

Particulars	(Rs. In lakhs)
Profit from the manufacturing unit set up in SEZ (Export turnover/Total Turnover = 90%)	80
Profit from the manufacturing unit in Non-SEZ area	-40
Income from other sources	22
Amount eligible for deduction under section 80G	5

Compute total income of Rajesh Exports Pvt Ltd.

Solution**Computation of Total Income of Rajesh Export Pvt Ltd.**

Particulars	Rs.	Rs.
Profit from the manufacturing unit set up in SEZ	80	
Profit from the manufacturing unit in Non-SEZ Area	(40)	
Income under the head PGBP (A)		40
Income from Other sources (B)		22
Gross Total Income (A) plus (B)		62
Less: Deduction under section 80 G		(5)
Total Income before giving deduction under section 10AA (C)		57
Less: <i>Deduction under 10 AA</i> is lower of followings:		(57)
(a) <i>Total income as per (C) above</i>	57	
(b) <i>Deduction under section 10AA (90% of Rs. 80)</i>	72	
Total Income		Nil

Readers Note:**Practical 4**

Siddarth Ltd. has an undertaking (Unit-X) in Special Economic Zone (SEZ) and another undertaking (Unit- Y) in Free Trade Zone (FTZ) for manufacturing of computer software. It furnishes the following particulars for its 2nd year of operations:

Particulars	Unit X (Rs. In lakhs)	Unit Y (Rs. In lakhs)
Total Sales:	180	120
Export Sales : (Inclusive of Rs. 10 lacs for onsite development of computer software outside India by Unit X)	120	10
Profit earned[After claim of bad debts u/s 36(1)(vii) in Unit X]	63	36

DIVISION A-BASICS, RESIDENTIAL STATUS, EXEMPT INCOME 2 – INCOME WHICH DO NOT FORM PART OF...

Plant and machinery used in the business has been depreciated at 15% on straight line method (SLM) basis and depreciation of Rs. 9 lacs was charged to profit and loss account in the proportion of sales during the previous year.

Rs. 100 lacs were realized out of export sales in time and balance of Rs. 20 lacs become irrecoverable due to bankruptcy of one of the foreign buyers in Unit-X. Compute the deduction under section 10AA of the Income-tax Act, 1961 and taxable income of Siddarth Ltd. for the 2nd year.

Solution**Computation of total income of Siddarth Ltd.**

Particulars	Rs.	Rs.
Profits and gains of business or profession		
Unit X (See Note 4)	63,81,000	
Less: Deduction under section 10AA (See Working below)	(35,45,000)	28,36,000
Unit Y (See Note 4)		36,54,000
Total Income		64,90,000

Working Note:

Deduction under section 10AA in respect of Unit X (See Notes 1, 2 & 3)

$$= \text{Profits of Unit X} \times \frac{\text{Export turnover of the Unit X}}{\text{Total turnover of Unit X}}$$

$$= \text{Rs. } 63,81,000 \times \frac{\text{Rs. } 1,00,00,000}{\text{Rs. } 1,80,00,000}$$

$$= \text{Rs. } 35,45,000$$

Notes:

- (1) It is assumed that Unit X has fulfilled all the specified conditions for claiming deduction under section 10AA of the Act. Unit Y is, however, not eligible for deduction under section 10AA in respect of the exports made by it since it is located in a Free Trade Zone.
- (2) Export turnover, for the purpose of section 10AA, means the consideration received in respect of export by the unit in SEZ. Therefore, in this case, the amount of Rs. 20,00,000 which has become irrecoverable due to bankruptcy of one of the foreign buyers in Unit X will not be included in its export turnover. Therefore, export turnover of Unit X (in SEZ) = Rs. 1,20,00,000 – Rs. 20,00,000 = Rs. 1,00,00,000.
- (3) Profits and gains from on site development of computer software outside India shall be deemed to be the profits and gains derived from export of computer software outside India. Since the same has already been included in the figure of export sales, no further adjustment is required.
- (4) Computation of unit-wise profits of the business

Particulars	Unit X (Rs.)	Unit Y (Rs.)
Profit earned [after claim of bad debts u/s 36(1)(vii) in Unit X]	63,00,000	36,00,000
Add: Depreciation calculated on SLM basis and charged in the proportion of sales (3:2)	5,40,000	3,60,000
Sub-total	68,40,000	39,60,000
Less: Depreciation calculated @15% on WDV basis and charged in the proportion of sales (3:2) (See Note 5)	(4,59,000)	(3,06,000)
Profits of the business	63,81,000	36,54,000

(5) Depreciation as per the Income-tax Rules, 1962 for the 2nd year has to be calculated as follows–

Particulars	Unit X (Rs.)
Actual cost of plant and machinery (Rs. 9,00,000 / 15%)	60,00,000
Less: Depreciation @15% for the first year of operations. It is logical to assume that the assets were put to use for more than 180 days during the year.	9,00,000
Written down value as on 1.4.2018	51,00,000
Depreciation @15% on WDV for 2nd year (Rs. 51,00,000 × 15%)	7,65,000

Readers Note:

2.7 | RESTRICTIONS ON ALLOWABILITY OF EXPENDITURE

Section:- 14A and Rule 8D

Section 14A(1): As per section 14A, expenditure incurred in relation to any exempt income is not allowed as a deduction while computing income under any of the five heads of income.

Section 14A(2): The Assessing Officer is empowered to determine the amount of expenditure incurred in relation to such income which does not form part of total income in accordance with such method as may be prescribed. Such method shall be adopted by the Assessing Officer if he is not satisfied with the correctness of the claim of the assessee, having regard to the accounts of the assessee.

Section 14A(3): Further, the Assessing Officer is empowered to adopt such method, where an assessee claims that no expenditure has been incurred by him in relation to income which does not form part of total income.

Rule 8D

Rule 8D lays down the method for determining amount of expenditure in relation to income not includible in total income. If the Assessing Officer, having regard to the accounts of the assessee of a previous year, is not satisfied with –

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

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

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

- (i) the amount of expenditure directly relating to income which does not form part of total income;
- (ii) an amount equal to 1% of the opening and closing balance of the annual average of the monthly average of the value of investment, income from which does not form part of total income. However, such amount cannot exceed the total expenditure claimed by the assessee.

Clarification regarding disallowance of expenses under section 14A in cases where corresponding exempt income has not been earned during the financial year [Circular No. 5/2014, dated 11.2.2014]

Section 14A provides that no deduction shall be allowed in respect of expenditure incurred relating to income which does not form part of total income. A controversy has arisen as to whether disallowance can be made by invoking section 14A even in those cases where no income has been earned by an assessee, which has been claimed as exempt during the financial year.

The CBDT has, through this Circular, clarified that the legislative intent is to allow only that expenditure which is relatable to earning of income. Therefore, it follows that the expenses which are relatable to earning of exempt income have to be considered for disallowance, irrespective of the fact whether such income has been earned during the financial year or not.

Practical 5

Mr. W has provided the following information regarding his income and expenditure of the relevant previous year.

Particulars	Rs.
Income from business (computed)	5,00,000
Dividend income from Money Market Mutual Funds	1,25,000
Consultancy charges to Mutual Fund agent	15,000
Interest expenditure relating to both taxable and non-taxable income	2,25,000

Annual average of the monthly average of the opening and closing balances of the value of investments in mutual fund is Rs. 50,00,000.

Value of total assets as appearing in Balance Sheet as on first day and last day of the previous year are Rs. 50,00,000 and Rs. 70,00,000.

Mr. W claims that no expenditure was incurred by him for exempt income earned. The Assessing Officer is not satisfied with the correctness of the claim of the assessee in respect of expenditure in relation to exempt income. You are required to compute the amount of expenditure incurred in relation to exempt income and resultant total income, assuming that Mr. W has no other income.

Solution

In this case, Mr. is in receipt of dividend income which represents exempt income and further he claims that no expenditure is incurred for the purpose of earning this income, the assessing officer is empowered to invoke Rule 8D. The computation as per Rule 8D is given as under:

Particulars	Rs.
(i) The amount of expenditure directly relating to exempt income	
• Consultancy charges paid to Mutual Fund Agent	15,000
(ii) 1% of the annual average of the monthly average of the opening and closing balances of the value of investment in Mutual Fund Units 1% of 50,00,000	50,000
[The amount in (i) & (ii) put together should not exceed the total expenditure claimed by the assessee]	
Amount of expenditure in relation to exempt income	65,000

Computation of total income of Mr. W for the A.Y. 2019-20

Particulars	Rs.
Income from business (computed)	5,00,000
Add: Amount of expenditure in relation to exempt income	65,000
Income from business / Total Income	5,65,000

Readers Note:

2.8 EXEMPTION UNDER SECTION 10(34) NOT TO APPLY TO DIVIDEND CHARGEABLE TO TAX IN ACCORDANCE WITH SECTION 115BBDA

Section:- 115BBDA and 10(34) - Effective from A.Y. 2017-18 further Amended by FA 2017

- Section 115BBDA provides that any income by way of aggregate dividends (declared, distributed or paid by domestic company or companies) in excess of Rs. 10 lakh shall be chargeable to tax in the case of a **specified assessee** who is resident in India, at the flat rate of 10%.
- Further, basic exemption limit of Rs.2,50,000 / Rs.3,00,000 / Rs.5,00,000 shall not be available while taxing such dividend income in excess of Rs.10 lakh.

DIVISION A-BASICS, RESIDENTIAL STATUS, EXEMPT INCOME 2 – INCOME WHICH DO NOT FORM PART OF...

- Further, no deduction in respect of any expenditure or allowance or set-off of loss shall be allowed to the assessee in computing the income by way of such dividends.
- Dividend for the purpose of this section means every dividend as covered by section 2(22) except section 2(22)(e).
- For the purpose of this section, **specified assessee means any person other than-**
 - Domestic company
 - Fund or institution or trust or university or medical institution referred to in section 10(23C)(iv)/(v)/(vi)/(via)
 - Trust or institution registered under section 12A or section 12AA
- Further, a proviso has been inserted to section 10(34) to provide that dividend income which is subject to section 115BBDA shall not be exempt in the hands of shareholder.

Practical 6

Find out tax liability of Mr. X and Mr. Y for the relevant previous year.

Particulars	Mr. X (Rs.)	Mr. Y (Rs.)
Income under head PGBP	(15,00,000)	(9,00,000)
Dividend from Indian Companies on which CDT has been paid	18,00,000	7,30,000
Dividend received from a foreign company	3,00,000	3,00,000

Solution**Points to be considered while computing total income and tax liability of Mr. X**

Considering the provisions of section 115BBDA, Mr. X is subject to this section since dividend from Indian companies on which CDT has been paid exceeded Rs. 10,00,000. As a result, taxable dividend under section 115BBDA shall be Rs. 8,00,000. (Readers must note that for the purpose of section 115BBDA, dividend declared, distributed or paid by the domestic company alone shall be considered and not the dividend from foreign companies). Such dividend shall be taxed at the flat rate of 10% without being set off of any loss.

However, dividend from foreign companies shall be charged to tax u/s 56 of the Act in the hands of shareholder. Since, such dividend is not subject to section 115BBDA, therefore, set off is available against such dividend income.

Considering the above remarks, **Total Income of Mr. X** is computed as under:

Particulars	Rs. In lakhs
Income under head PGBP	(15,00,000)
Dividend from Indian Companies on which CDT has been paid	8,00,000
Dividend from a foreign company	3,00,000
Total Income	8,00,000

Note: Loss under the head "PGBP" Rs.12,00,000 (Rs.15,00,000–Rs. 3,00,000) shall be c/f for next 8 A.Ys.

Computation of Tax liability of Mr. X

Tax on Rs.8,00,000 @ 10.40% (including education cess) = Rs. 83,200

Points to be considered while computing total income and tax liability of Mr. Y

Mr. Y is not subject to section 115BBDA since dividend from Indian companies on which CDT has been paid (Rs.7,30,000 in present case) did not exceed Rs. 10,00,000. (Readers must remember that for the purpose of section 115BBDA, dividend declared, distributed or paid by the domestic company alone shall be considered and not the dividend from foreign companies). Hence entire dividend income of Rs. 7,30,000 is exempt under section 10(34) in the hands of Mr. Y.

DIVISION A-BASICS, RESIDENTIAL STATUS, EXEMPT INCOME 2 – INCOME WHICH DO NOT FORM PART OF...

However, dividend from foreign company shall be charged to tax u/s 56 of the Act in the hands of shareholder. Since, such dividend is not subject to section 115BBDA, therefore, set off is available against such dividend income.

Considering the above remarks, **Total Income of Mr. Y** is computed as under:

Particulars	Rs.
Income under head PGBP	(9,00,000)
Dividend from Indian Companies on which CDT has been paid	Exempt under section 10(34)
Dividend from a foreign company	3,00,000
Total Income	(6,00,000)

Note: Loss under the head "PGBP" Rs.6,00,000 (Rs.9,00,000–Rs. 3,00,000) shall be c/f for next 8 A.Ys.

Computation of Tax liability of Mr. Y

Since total income is negative, tax payable is NIL.

Readers Note:

3 – SALARY

3.1 | STANDARD DEDUCTION TO SALARIED PERSON**Section:-** 16 - Effective from A.Y.2019-20

The income chargeable under the head "Salaries" shall be computed after making the following deductions:

(1) Standard Deduction {Section 16(ia)}

Deduction of Rs.40,000 or the amount of the salary, whichever is less [Inserted by Finance Act, 2018, w.e.f. A.Y.2019-20]

(2) Entertainment Allowance {Section 16(ii)}

Entertainment allowance received from employer shall be first included in salary and then deduction u/s 16(ii) will be allowed only to the Government employees which is least of the following:

- (a) Rs.5000/-
- (b) 20% of Basic salary
- (c) Actual amount of entertainment allowance

(3) Professional Tax or Tax on Employment {Section 16(iii)}

Professional tax or tax on employment levied under article 276(2) of the Constitution is allowed as a deduction.

3.2 | WITHDRAWAL OF EXEMPTION PERTAINING TO TRANSPORT ALLOWANCE**Section:-** 10(14) - Effective from A.Y.2019-20

Allowances	Exemptions limits
Transport allowance	~~Rs. 1600 p.m and~~ Rs. 3200 p.m for blind / handicapped employee

3.3 | WITHDRAWAL OF EXEMPTION PERTAINING TO REIMBURSEMENT OF MEDICAL EXPENDITURE**Section:-** 17(2) - Effective from A.Y.2019-20

The following shall not be treated as perquisite

(a) Medical treatment of the employee or his family (spouse and children, dependent-parents, brothers and sisters):

- Provided in any hospital maintained by the employer.
- Any sum paid by the employer towards expenditure actually incurred by the employee in any hospital:
 - Maintained by employer or Government or Local Authority or any other hospital approved by Central Government for the purposes of medical treatment of its employees;
 - Approved by the Chief Commissioner having regard to the prescribed guidelines in respect of prescribed diseases.

(b) Premium paid by an employer by cheque to General Insurance Corporation to effect/keep in force:

- Insurance on the health of his employees.
- Medical Insurance Premium.

(c) ~~Any sum, not exceeding ₹ 15,000 paid to any hospital/nursing home/clinic other than (a & b)~~

Practical 1

Mr. Krishna is a chartered accountant and employed by Dwarika Ltd. He is paid Rs.2,50,000 per month as salary and bonus equivalent to one month pay. Besides, Dwarika Ltd. provides the following-

- (1) Transport allowance: Rs. 1,600 per month.
- (2) Entertainment allowance: Rs. 4,000 p.a.
- (3) Medical facility in a hospital owned by Dwarika Ltd. Cost to the company for providing this facility to Mr. Krishna was Rs. Rs.51,000.
- (4) Medical facility in private hospital costing Rs.22,500 (this private hospital is approved by the Central Government for the medical treatment of its employees).
- (5) Medical facility in a hospital approved by the Chief Commissioner: Rs.5,000.
- (6) Medi-claim insurance premium paid by Dwarika Ltd. for Mr. Krishna and his family: Rs.15,000.
- (7) Reimbursement of other medical expenditure: 15,000.
- (8) Professional tax paid by employer: Rs.2,000

Determine the income from Salary.

4 – HOUSE PROPERTY

4.1	CALCULATION OF INCOME UNDER THE HEAD HOUSE PROPERTY UNDER DIFFERENT SITUATIONS

Situation 1 :- Where property is let out throughout the year

Income from a let out house property is determined as under:

Particulars	Rs.
Gross annual value	xxxx
Less : Municipal taxes	(xxxx)
Net annual value	xxxx
Less : Deduction under section 24	
(a) Standard deduction (30% of Net Annual Value)	(xxxx)
(b) Interest on borrowed capital (deductible on accrual basis without any limit)	(xxxx)
Income from house property	xxxx

Situation 2 :- Where property is self-occupied throughout the year:

Particulars	Rs.
Gross annual value	Nil
Less : Municipal taxes	Nil
Net annual value	Nil
Less : Deduction under section 24	
(a) Standard deduction (30% of Net Annual Value)	Nil
(b) Interest on borrowed capital subject to limit (Refer Note)	xxxx
Income from house property	xxxx

Note:- Interest (including pre-construction period interest) is deductible subject to following limits:

- (1) If amount has been borrowed for purchase, construction, repair or renovation of house property, then interest is generally deductible upto Rs. 30,000 p.a.
- (2) Above limit of Rs. 30,000 shall be increased to Rs. 2,00,000, if following conditions are satisfied:-
 - (i) Amount has been borrowed on or after 1st April 1999 and
 - (ii) Amount has been borrowed for purchase or construction of House Property and
 - (iii) Purchase or construction has been completed within five years from the end of financial year in which amount has been borrowed.

Practical 1

Mr. Gajanan provides following information:

- (i) He inherits plot of land since 1990.
- (ii) For construction of residential house, he borrowed from State Bank of India on 14-2-2013.
- (iii) He started construction of house property on 15-5-2013.
- (iv) The construction of house property was completed on 10-5-2018.
- (v) This house property was self-occupied during previous year 2018-19.
- (vi) Interest payable to SBI for the financial year 2018-19 was Rs.2,30,000.
- (vii) Municipal tax for the financial year 2018-19 was Rs. 1200

Find out income under the head house property in the hands of Mr. Gajanan.

Solution

Considering the above, the computation of income under the head house property in case of Mr. Gajanan for the financial year 2018-19 is as under:

Particulars	Rs.
Gross Annual Value	Nil
Less: Municipal Taxes paid during the previous year	Nil
Net Annual Value	Nil
Less: 30% of Net Annual Value	Nil
Less: Interest on borrowed capital –section 24(b)	(30,000)
Income under the head house property	(30,000)

Remark:

Apparently, it seems that Mr. Gajanan has completed construction within 5 years. However, for the purpose of section 24(b), one of the conditions to claim higher limit of Rs.2,00,000 is that construction shall be completed **within 5 years from the end of financial in which capital was borrowed.** (Readers must note that it is not from the date of commencement of construction) In the given case, the amount was borrowed on 14-2-2013 therefore construction should have been completed on or before 31-3-2018.

Readers Note:

Situation 3 :- When the property is not occupied during the whole previous year due to employment, business or profession carried on at some other place:

When the property is not occupied by the individual during the whole previous year due to employment, business or profession carried on at some other place then computation under this head shall be done as if it is self-occupied property (as discussed in Situation 2) provided all the following conditions are satisfied:

- (a) Concerned property is not let out during the previous year.
- (b) He has to reside at that other place in property not owned by him.
- (c) No other benefit had been derived from the concerned property.

Situation 4 :- When Property is let out for some period and self-occupied for remaining period during the previous year:

For this situation, net income under the head “house property” shall be computed as if the property were let out throughout the previous year (as discussed in Situation 1).

Situation 5 :- House Property consists of two independent units of which one is let out and the other is self-occupied.

For this situation, net income under the head “house property” shall be computed as under:-

- (a) For Let out Unit : - As discussed in Situation 1
- (b) For Self-occupied Unit :- As discussed in Situation 2

Situation 6 :- House Property consists of three independent units of which first one is let out, second one is self occupied and last one is used for the purpose of business

For this situation, net income under the head “house property” shall be computed as under:-

- (a) For Let out Unit : - As discussed in Situation 1
- (b) For Self-occupied Unit :- As discussed in Situation 2

(c) For Business Unit:- As this unit is used for the purpose of business, it is outside the purview of head "Income from house property".

However for the business unit, assessee can claim following deductions under the head "Profit & gain from business & profession"

(a) Repairs & Maintenance

(b) Insurance

(c) Depreciation

(d) Municipal tax –Allowed as deduction if it is deposited on or before due date of filing return u/s 139(1)-Section-43B.

Situation 7 :- When assessee owns more than one residential house property and all are reserved for self-occupation.

For this situation, at the option of assessee, one house property is to be selected as self occupied and other house properties shall be deemed to be let out.

The one house which has been selected as self-occupied, computation shall be done as per Situation 2.

While for deemed to be let out properties, computation shall be done as per Situation 1 – For deemed to be let out properties, Gross Annual Value shall be Expected Rent.

Situation 8 :- When house property is held in stock in trade [Section 23(5)]

Where the property consisting of any building or land appurtenant thereto is held as stock-in-trade and

the property or any part of the property is not let during the whole or any part of the previous year, the annual value of such property or part of the property,

for the period up to one year from the end of the financial year in which the certificate of completion of construction of the property is obtained from the competent authority,

shall be taken to be nil.

Situation 9 :- When house property is owned by more than one owner [Co-owner]

If a house property is owned by two or more persons, then such persons are known as co-owners. Tax treatment of such property is given under section 26. Section 26 is applicable if the following conditions are satisfied –

(a) The property must consist of building or building and land appurtenant thereto

(b) It is owned or deemed to be owned by two or more persons.

(c) The respective shares of the co-owners are definite and ascertainable.

If above conditions are satisfied, then computation shall be done, as if each co-owner is the complete owner of his respective share in the house property.

4.2 | AMOUNTS NOT DEDUCTIBLE FROM INCOME FROM HOUSE PROPERTY

Section:- 25

Any interest chargeable under this Act which is payable outside India, on which tax has not been paid or deducted under Chapter XVII-B, shall not be deducted in computing the income chargeable under the head "Income from house property".

4.3 TAXABILITY OF UNREALISED RENT AND ARREARS OF RENT.**Section:- 25A**

At present, section 25AA deals with taxability of unrealised rent when realised subsequently and section 25B deals with the tax treatment of arrears of rent received.

These two provisions are now merged in new section 25A. The summary of new section 25A is as under:

Sr. No.	Taxability of Arrears of Rent or Unrealised Rent
(i)	Taxable in the year of receipt or
(ii)	Deduction@30% of rent received
(iii)	Taxable even if assessee is not the owner of the property in the financial year of receipt

Practical 2

Mr. Parmanand provides following information:

- In July, 2018, he recovered unrealized rent of Rs. 50,000 (which was reduced from Gross Annual Value earlier) from Mr. Saif (tenant).
- In October, 2018, he received arrears of rent (which was not taxed earlier) of Rs. 70,000 from State Bank of India (tenant).

Discuss taxability of above receipts in the hands of Mr. Parmanand under following alternatives:

- Mr. Parmanand has already sold out the captioned house property on 10-2-2018
- Mr. Parmanand continued to own the house property in previous year 2018-19.

Solution**Computation of income from house property of Mr. Parmanand for A.Y.2017-18**

Particulars	Rs.
(i) Unrealised rent recovered from Mr. Saif	50,000
(ii) Arrears of rent received from SBI	70,000
	1,20,000
Less: Deduction@30%	(36,000)
Income from house property	84,000

Reader's Note:

5 — PROFITS AND GAINS FROM BUSINESS OR PROFESSION**UNIT A – TAXABILITY AND ALLOWANCES****5.1 | CHARGEABILITY UNDER THE HEAD “PGBP” EXPANDED****Section:- 28 – Effective from A.Y.2019-20**

Section	Chargeable Income
28(ii)	Compensation or other payment received by, - (a) any person managing the whole or substantially the whole of affairs of an Indian company, at or in connection with the termination of his management or the modification of the terms and conditions relating thereto; (b) any person managing the whole or substantially the whole of the affairs in India of any other company, at or in connection with the termination of his office or the modification of the term and conditions relating thereto; (c) any person, holding an agency in India for any part of the activities relating to the business of any other person, at or in connection with the termination of the agency or the modification of the terms and conditions relating thereto; (d) any person, for or in connection with the vesting in the Government or in any corporation owned or controlled by the Government, under any law for the time being in force, of the management of any property or business. (e) any person at or in connection with the termination or the modification of the terms and conditions, of any contract relating to his business; [Amended by Finance Act, 2018 w.e.f. A.Y.2019-20]

Practical 1

The assessee, Saurashtra Cement Ltd., 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.

Discuss the taxability of such compensation in the hands of a company:

- (a) before the amendment made by Finance Act, 2018 in section 28 of the Act
- (b) After the amendment made by Finance Act, 2018 in the said section.

Section	Chargeable Income
28(via)	the fair market value of inventory as on the date on which it is converted into, or treated as, a capital asset determined in the prescribed manner. [Amended by Finance Act, 2018 w.e.f. A.Y.2019-20]



SECTION 49(9): For detailed discussion: Refer Chapter 6 -Capital Gains

5.2 | TEA OR COFFEE OR RUBBER DEVELOPMENT ACCOUNT**Section:- 33AB****(A) Who can claim?**

All assesses who carry on the business of growing and manufacturing tea or coffee or rubber in India.

(B) Conditions:

- (a) The assessee shall deposit the amount with NABARD / Tea or Coffee or Rubber Development Account within 6 months from the end of the relevant previous year or before the due date of filing return under section 139(1), whichever is earlier.
- (b) The accounts of the assessee of this business shall be audited by a chartered accountant and audit report shall be furnished in a prescribed form along with his return of income.

(C) Quantum of deduction:

Least of the following is deductible:

- (a) Amount deposited; or
- (b) 40% of profits or gains of business or profession before making any deduction under this section and u/s. 72 (i.e. before claiming set off).

(D) Where any deduction is allowed under this section, no deduction shall be allowed in respect of such amount in any other previous year.**(E) Deduction under this section shall not be allowed in computation of income of a partner of a firm or member of AOP or BOI.****(F) Manner of utilisation of deposit:**

The amount kept in the deposit will not be allowed to be withdrawn except for the purposes specified in the scheme.

(G) Ineligible Assets:

- (a) Any machinery or plant installed in office or residential accommodation or guesthouse.
- (b) Any office appliances other than computer
- (c) Any machinery or plant entitled for 100% depreciation or deduction under the Act.
- (d) Any new plant or machinery to be installed in an industrial undertaking manufacturing any article specified in Eleventh Schedule.

(H) Taxability treatment of deposits in case of closure of business:

Event of closure	Taxability
(i) Closure of business; (ii) Dissolution of firm	Amount withdrawn shall be deemed to be the profits and gains of the previous year in which it is withdrawn (i.e. it is taxable under the head "PGBP")
(iii) Death of assessee; (iv) Partition of HUF (v) Liquidation of Company	Amount withdrawn shall not be taxable.

(I) Subsequent withdrawal of benefit claimed under section 33AB:

- (a) Non-utilisation / mis-utilisation:-** The amount withdrawn during any previous year is not utilised within the previous year or utilised for a purpose other than those specified in the scheme, then it shall be treated as the income and charged to tax in that previous year.
- (b) Subsequent sale of asset:** Where the asset acquired in accordance with the scheme is transferred or sold within 8 years from the end of the previous year in which it was acquired, the portion of the deduction allowed shall be treated as income of the previous year in which the asset is sold or otherwise transferred. The above provision relating to subsequent sale of asset shall not apply in the following situations:
- (i)** Transfer to Government or local authority or Corporation or Government Company
 - (ii)** Succession of firm by a company

Practical 2

X Ltd., is a company engaged in the business of growing, manufacturing and selling of tea. It provides following information for the accounting year ended **31st March, 2018**.

- (i) Composite business profits, before an adjustment u/s 33AB of the Income-tax Act, were Rs.60 lakhs.
- (ii) In the year, it deposited Rs.20 lakhs with NABARD. The company has a business loss of Rs.10 lakhs brought forward from the previous year.

Indicate clearly the tax consequences of the above transaction and the total income for the relevant year.

Solution

Before we refer solution, let's understand following important point:

Computation of agricultural income of an assessee who grows and manufactures tea, coffee or rubber.

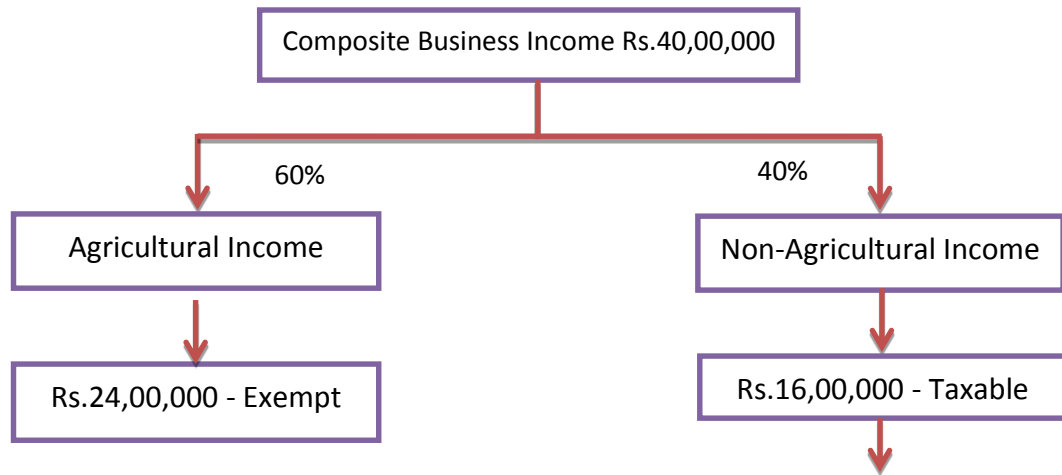
First of all, we have to determine income under the head "Profit and Gains of Business" (POB) as if entire activity is chargeable to tax and

thereafter such income shall be bifurcated in the following manner:

Nature of Business	Agricultural Income	Non-Agricultural Income
Sale of centrifuged latex or cenex manufactured from rubber	65% of POB	35% of POB
Sale of coffee grown, cured, roasted and grounded by seller in India	60% of POB	40% of POB
Sale of coffee grown and cured by seller in India	75% of POB	25% of POB
Growing and manufacturing tea	60% of POB	40% of POB

P.Y. 2017-18**A.Y. 2018-19**

Particulars	Rs.
Business Income before deduction u/s 33AB	60,00,000
Less: Deduction u/s 33AB [W.N.1]	(20,00,000)
Composite Business Income under the head 'PGBP'	40,00,000



Particulars	Rs.
Income	16,00,000
Less: B/f business loss	(10,00,000)
Taxable Income	6,00,000

Working Note 1:

Deduction u/s 33AB is

(a) Amount deposited : Rs. 20,00,000

(b) 40% of Rs.60,00,000 : Rs. 24,00,000

Whichever is lower.

Reader's Note:

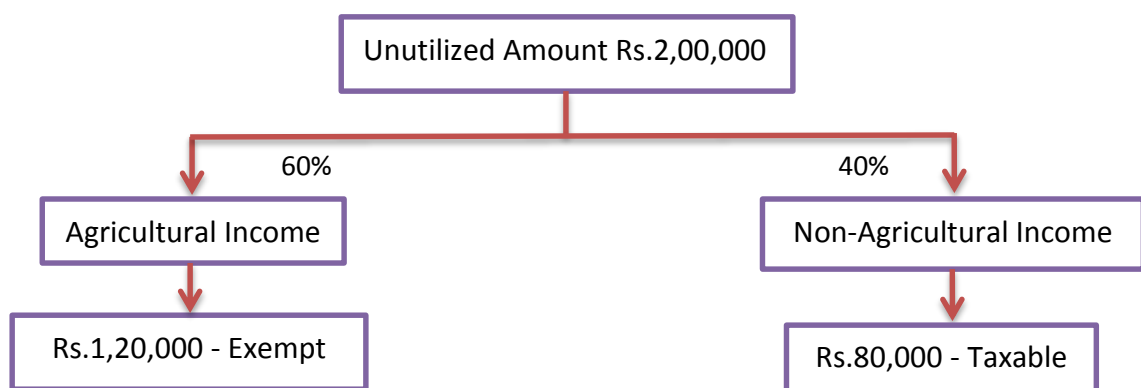
Practical 3

Continuing **Practical 4**, the company withdrew in **February, 2020** Rs.20 lakhs from the deposit account to buy a non-depreciable asset for Rs.18 lakhs and could not use the balance before the end of the accounting year. The withdrawal and the purchase were under a scheme approved by the Tea Board.

Indicate clearly the tax consequences of the above transaction and the total income for the relevant year.

Solution

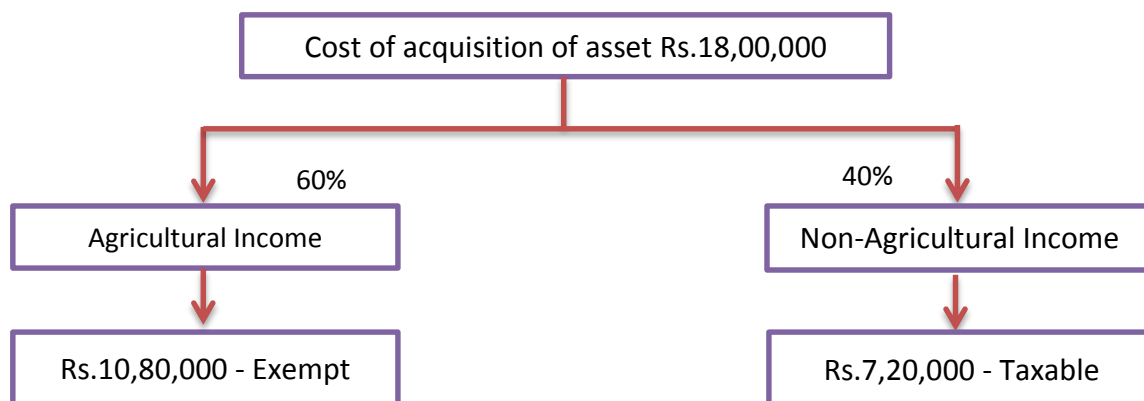
	P.Y. 2019-20	A.Y. 2020-21
Particulars	Rs.	
Amount withdrawn from a special account during the previous year 2019-20	20,00,000	
Less: Amount utilised during the same previous year (i.e., 2019-20)	(18,00,000)	
Amount unutilized		2,00,000

Tax Treatment of Unutilized Amount

Reader's Note:

Practical 4

Continuing **Practical 4 and Practical 5**, the non-depreciable asset was sold in **November, 2022** for Rs.29 lakhs. Indicate clearly the tax consequences of the above transactions and the total income for the relevant years.

Solution**P.Y. 2022-23****A.Y. 2023-24****(1) Tax Treatment under the head 'Profit and Gains from Business or Profession'****(2) Tax Treatment under the head 'Capital Gains'**

Period of holding: February, 2020 to November, 2022 (i.e., not exceeding 36 months)

Nature of Asset: Short term capital asset

Computation of Capital Gain

Particulars	Rs.
Full value of consideration	29,00,000
Less: Cost of acquisition	(18,00,000)
Short Term Capital Gain	11,00,000

Reader's Note:

5.3 EXPENDITURE ON SCIENTIFIC RESEARCH**Section:- 35****(A) Deduction of expenditure on in house research by any assessee [Section 35(1)(i) and (2)]**

The following expenditure **incurred** by the assessee on scientific research in relation to the assessee's business shall be allowed as deduction:

- (i) Current year revenue expenditure on scientific research.
- (ii) Current year capital expenditure on scientific research.
- (iii) Prior period revenue expenditure or capital expenditure incurred during 3 years immediately preceding the date of commencement of business will be allowed as deduction in the previous year in which the assessee commences the business.
- (iv) Revenue expenditure of a prior period shall be the payment of salary (excluding perquisites) to research personnel and material cost used for research.
 - Prior period revenue expenditure shall be deductible to the extent certified by prescribed authority.
 - But prior period capital expenditure are not required to be certified by prescribed authority.
- (v) The expenditure on acquisition of land will not be allowed as a deduction.
- (vi) The assessee is not entitled to claim any depreciation on the capital expenditure which has been allowed as deduction u/s. 35(2).

(B) Deduction for expenditure on in house research by companies in special business [Section 35(2AB)]

- (i) In case of a company engaged in the business of bio-technology or any business of manufacture or production of any article or thing except those specified in the Eleventh Schedule, an amount equal to 150% of the expenditure incurred on scientific research shall be allowed as deduction.
- (ii) The cost of any land or building shall not be allowed as a deduction.
- (iii) Once deduction is claimed under this section, then same expenditure shall not be allowed as deduction under any other provision of Income Tax Act.
- (iv) For the purpose of claiming deduction under this section, company shall enter into an agreement with the prescribed authority for co-operation in such research and development facility and fulfils such conditions with regard to maintenance of accounts and audit thereof and furnishing of reports in such manner as may be prescribed.
- (v) The prescribed authority shall submit its report in relation to the approval of the said facility to the Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General in such form and within such time as may be prescribed.

Comparison between {Section 35(1) (i) /(2)} and {Section 35(2AB)}

Section No.	Who can Claim?	Nature of Expenditure	Percentage of Deduction	Whether Prior Period covered?	Restriction
35(1)/(2)	Any assessee	Revenue/Capital	100%	Yes	Land
35(2AB)	Company in Special Business	Capital as well as Revenue	150%	No	Land & Building

Section 35(1) and 35(2) are applicable to any assessee including company in special business also. Therefore, company in special business can claim-

- (a) deduction of building at 100 %.
- (b) deduction of prior period capital as well as revenue expenditure at 100%.

Practical 5

An assessee commenced production of chemicals on **1st November, 2018**. It has made the following expenditure on scientific research before commencement of production:

- (a) Salary to research personnel and the cost of research material during the 12 months ending on **31st October, 2015**: Rs.8,30,000.
- (b) Salary to research personnel from **1st November, 2015 to 31st October, 2018**: Rs.24,50,000 (out of which amount certified by the prescribed authority was Rs.18,12,000)
- (c) Expenditure on providing rent – free flats to research personnel, from **1st November, 2015 to 31st October, 2018**: Rs.1,80,000.
- (d) Cost of research material from **1st November, 2015 to 31st October, 2018**: Rs.18,75,200 (out of which amount certified by the prescribed authority was Rs.17,44,800).
- (e) Capital expenditure on scientific research upto **31st October, 2015** –
 - (i) Payment towards purchase of land : Rs. 50,00,000.
 - (ii) Payment towards construction of laboratory building: Rs.12,00,000.
 - (iii) Purchase of plant and machinery to be used in laboratory: Rs. 17,00,000.
- (f) Capital expenditure on scientific research between **1st November, 2015 to 31st October, 2018** - not certified by the prescribed authority
 - (i) Payment towards purchase of land : Rs. 20,00,000.
 - (ii) Payment towards construction of laboratory building: Rs.6,00,000.
 - (iii) Purchase of plant and machinery to be used in laboratory: Rs. 28,00,000.

(g) Revenue expenditure on scientific research incurred after commencement of business: Rs. 20,00,000.

Determine the amount of deduction available under section 35 under following alternatives assuming that the scientific research is related to the business of the assessee :

Alternative (1) : An assessee is a partnership firm.

Alternative (2): An assessee is an Indian company engaged in special business.

Solution

Alternative 1: An assessee is a partnership firm

Statement showing deduction under section 35

Particulars	Rs.
a. Expenditure incurred till October 2015 -not deductible as it is incurred beyond 3 years.	Not Deductible
b. Prior period revenue expenditure incurred during 3 years immediately preceding 01.11.2018 to the extent certified by prescribed authority.	18,12,000
c. Expenditure on providing perquisites (i.e, rent – free flats) to research personnel	Not Deductible
d. Expenditure on research material to the extent certified by prescribed authority.	17,44,800
e. Capital expenditure incurred till October 2015 –not deductible as it is incurred beyond 3 years.	Not Deductible
f. Capital expenditure incurred during 3 years immediately preceding 01.11.2018 . (Certification of prescribed authority not required)	
(i) Purchase of land	Not Deductible
(ii) Construction Cost	6,00,000
(iii) Cost of plant and machinery	28,00,000
g. Revenue expenditure on research after commencement of business.	20,00,000
Total deduction under section 35	89,56,800

Alternative 2: An assessee is an Indian company engaged in special business

Statement showing deduction under section 35

Particulars	Rs.
a. Expenditure incurred till October 2015 -not deductible as it is incurred beyond 3 years.	Not Deductible
b. Prior period revenue expenditure incurred during 3 years immediately preceding 01.11.2018 to the extent certified by prescribed authority. (at 100%)	18,12,000
c. Expenditure on providing perquisites (i.e, rent – free flats) to research personnel	Not Deductible
d. Expenditure on research material to the extent certified by prescribed authority. (at 100%)	17,44,800
e. Capital expenditure incurred till October 2015 –not deductible as it is incurred beyond 3 years.	Not Deductible
f. Capital expenditure incurred during 3 years immediately preceding 01.11.2018 . (Certification of prescribed authority not required)	
(i) Purchase of land	Not Deductible
(ii) Construction Cost (at 100%)	6,00,000
(iii) Cost of plant and machinery (at 100%)	28,00,000
g. Revenue expenditure on research after commencement of business. (at 150%)	30,00,000
Total deduction under section 35	99,56,800

Reader's Note:

(C) Contribution made to outsiders [Section 35(1)(ii)/(iii)/(iiia) and Section 35(2AA)]

Where assessee makes contributions to other institutions for research purpose, a weighted deduction is allowed, as follows-

Section No.	To whom contribution can be given?	To be utilized for?	Weighted deduction from the A.Y. 2018-19 to 2020-21	Weighted deduction A.Y. 2021-22 onwards
35 (1) (ii)	An approved association or an approved university, college or other institution	Scientific research	150 % of contribution	100 % of contribution
35 (1) (iii)	An approved association or an approved university, college or other institution	Social science research or Statistical research	100 % of contribution	100 % of contribution
35 (2AA)	National Laboratory, University, IIT or specified person approved by prescribed authority	Scientific research	150% of Contribution	100% of Contribution
35(1)(ia)	Company registered in India having main object of scientific research and development provided such company is time being approved by the prescribed authority	Scientific research	100% of Contribution	100% of Contribution

Notes:

1. Above deduction can be claimed by any assessee even if research is not related to assessee's business.
2. Deduction in respect of above contribution made to above institutions shall not be denied merely on the ground that, subsequent to contribution made by assessee, the approval granted to these institutions have been withdrawn.

Practical 6

PQR private limited has shown a net profit of Rs. 32,88,000 after debiting following items:

1. Rs.1,00,000 paid to the Indian Agricultural Research Institute, New Delhi, being an approved scientific research institution u/s 35(1)(ii) for the purpose of carrying out scientific research in natural science.
2. Rs.75,000 paid to the Indian Institute of Management, Ahmedabad being an approved institute u/s 35(1)(iii), for the purpose of carrying out scientific research in social or statistical science.
3. Rs.51,000 paid to an approved National Laboratory for carrying out scientific research.
4. Rs. 11,000 paid to IIT for carrying out scientific research.
5. Rs. 30,000 paid to TATA Research Limited, an Indian company approved under section 35(1) (ia) for carrying out scientific research.

Find out income of PQR private limited under the head "PGBP".

Solution

Particulars	Rs.
Net Profit as per Profit & Loss account	32,88,000
Add: Contribution to Indian Agricultural Research Institute, New Delhi	1,00,000
Less: Contribution to Indian Agricultural Research Institute, New Delhi-Section 35(1)(ii) [150% of Rs.1,00,000]	(1,50,000)

Add:	Contribution to Indian Institute of Management, Ahmedabad	75,000
Less:	Contribution to Indian Institute of Management, Ahmedabad – Sec.35(1)(iii) [100% of Rs.75,000]	(75,000)
Add:	Contribution to approved National Laboratory	51,000
Less:	Contribution to approved National Laboratory-Sec. 35(2AA)[150% of Rs.51,000]	(76,500)
Add:	Contribution to IIT	11,000
Less:	Contribution to IIT - Section 35(2AA) [150% of Rs.11,000]	(16,500)
Add:	Contribution to TATA Research Limited	30,000
Less:	Contribution to TATA Research Limited- Section 35(1) (iaa)[100% of Rs.30,000]	(30,000)
Income under head "PGBP"		32,07,000

Reader's Note:

Practical 7

ABC Scientific Research (P) Ltd is a company registered in India and approved u/s 35(1)(iaa) as well as eligible to claim deduction under section 35(2AB). During previous year it spent Rs. 3 crore on scientific research related to its business. Can it claim 150% of Rs.3 crore as deduction u/s 35(2AB)?

Solution

On close reading of the clarification given under Section 35(1)(iaa), company approved for accepting contribution under section 35(1)(iaa) cannot claim weighted deduction of 150 percent under section 35(2AB). Considering the same, ABC Scientific Research (P) Ltd. cannot claim weighted deduction under section 35(2AB).

However, the restriction is for section 35(2AB) and not for section 35(1) and 35(2). Therefore, it can claim deduction of Rs. 3 crore.

Reader's Note:

(D) Carry forward and set off of unabsorbed scientific research expenditure

It shall be given the same treatment as is given to the unabsorbed depreciation.

5.4 DEDUCTION IN RESPECT OF EXPENDITURE ON SPECIFIED BUSINESS

Section:- 35AD

(1) Conditions

- Assessee must be carrying on "specified business".
- The specified business should not be set up by splitting up, or the reconstruction, of a business already in existence.
Not only that, it should not be set up by the transfer of old plant and machinery. However, in following two cases old machinery is permitted:
Case 1:- If the value of the old assets does not exceed 20 per cent of the total value of the plant and machinery, this condition is deemed to have been satisfied.
Case 2:- Second-hand imported machinery is treated as new subject to satisfaction of few conditions in this regard.
- Books of account of the assessee must be audited.

(2) Quantum of Deduction

Sr. No.	Specified business	Quantum of deduction (Percentage of capital Expenditure)
1.	Setting up and operating a cold chain facility (Refer Note 1)	100%
2.	Setting up and operating a warehousing facility for Storage of agricultural produce	100%
3. *	Laying and operating a cross-country natural gas or crude or petroleum oil pipeline network for distribution, including storage facilities being an integral part of such network. (Refer Note 2)	100%
4.	Building and operating anywhere in India a new hotel of 2 star or above category (Refer Note 3)	100%
5.	Building and operating anywhere in India, new hospital with at least 100 beds for patients	100%
6.	Developing and building a housing project under a scheme for slum redevelopment or rehabilitation	100%
7.	Developing and building a housing project under a scheme for affordable housing	100%
8.	Production of fertilizer in India	100%
9.	setting up and operating an inland container depot or a container freight station	100%
10.	Bee-keeping and production of honey and beeswax	100%
11.	setting up and operating a warehousing facility for storage of sugar	100%
12.	Laying and operating a slurry pipeline for the transportation of iron ore	100%
13.	Setting up and operating a semiconductor wafer fabrication manufacturing unit.	100%
14. *	Developing or maintaining and operating or developing, maintaining and operating a new infrastructure facility (Amendment by Finance Act, 2016 but effective from A.Y. 2018-19) (Refer Note 4)	100%

* The benefit of deduction under this section is available to a company formed under Companies Act, 1956 or a consortium of such companies or an authority or a board or a corporation established under Central or State Act.

Notes

- "Cold chain facility" means a chain of facilities for storage or transportation of agricultural and forest produce, meat and meat products, poultry, marine and dairy products, products of horticulture, floriculture and apiculture and processed food items under scientifically controlled conditions including refrigeration and other facilities necessary for the preservation of such produce.
- This business shall make not less than one-third (for a natural gas pipeline network) or one-fourth (for petroleum product pipeline network) of its total pipeline capacity available for use on common carrier basis by any person other than the assessee or an associated person. Associated person is a person who participates in the management of the assessee; holds at least 26 per cent voting power in the assessee; appoints more than half of the board of directors or who guarantees not less than 10 per cent of the total borrowing of the assessee.

3. Where the assessee builds a hotel of two-star or above category as classified by the Central Government and subsequently, while continuing to own the hotel, transfers the operation thereof to another person, the assessee shall be deemed to be carrying on the specified business.
4. infrastructure facility" means—
 - (i) a road including toll road, a bridge or a rail system;
 - (ii) a highway project including housing or other activities being an integral part of the highway project;
 - (iii) a water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system;
 - (iv) a port, airport, inland waterway, inland port or navigational channel in the sea.

(3) Year of Deductibility

Above mentioned deduction under section 35AD in respect of any capital expenditure (whether old or new) shall be allowed in the previous year in which such capital expenditure is incurred.

In case of expenditure incurred prior to the commencement of specified business, the same shall be allowed as deduction during the previous year in which the assessee commences the operation specified business, if the amount is capitalized in the books of account on the date of commencement of specified business.

(4) Restrictions

Capital expenditure incurred on the following shall not be eligible for deduction under section 35AD

- (i) land
- (ii) goodwill
- (iii) financial instrument
- (iv) any capital expenditure in respect of which the payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or an account payee bank draft or use of electronic clearing system through a bank account, exceeds Rs.10,000.

Practical 8

Priyanka warehouse LLP set up the operation of warehousing facility in Gujarat for storage of agricultural produce. It commenced operation with effect from **April 1, 2018**.

The following information is available from the records of LLP.

Particulars	Rs.
<u>Expenses incurred prior to April 1, 2018 and capitalized in the books</u>	
Purchase of land for warehouse	80,00,000
Construction cost of warehouse (Material)	12,00,000
Payment to labour contractor for construction of warehouse (single payment made in cash)	7,00,000
<u>Expenses incurred during 2018-19</u>	
Further construction cost of warehouse	50,00,000
Purchase of old plant and machinery (from India)	2,50,000
Purchase of old plant and machinery (from Denmark)	3,50,000
Purchase of new plant and machinery	9,00,000

Compute amount of deduction under section 35AD assuming that the books of accounts of Priyanka warehouse LLP have been audited.

Solution

Statement showing computation of deduction under section 35AD in the hands of Priyanka warehouse LLP:

Particulars	Rs.
<u>Expenses incurred prior to April 1, 2018 and capitalized in the books</u>	
Purchase of land for warehouse	Not Eligible for 35AD benefit
Construction cost of warehouse	12,00,000
Payment to labour contractor for construction of warehouse (Not eligible because single payment is made in cash exceeding Rs.10,000)	Nil
<u>Expenses incurred during 2018-19</u>	
Further construction cost of warehouse	50,00,000
Purchase of old plant and machinery (from India)	2,50,000
Purchase of old plant and machinery (from Denmark)	3,50,000
Purchase of new plant and machinery	9,00,000
Total Deduction under section 35AD	77,00,000

Reader's Note:

(5) Consequences Of Claiming Deduction Under Section 35AD

A. Basic Consequences

- (i) Once deduction has been claimed in respect of capital expenditure under section 35AD, the same cannot be claimed under any other provisions of the Income-tax Act. (e.g., depreciation under section 32, Investment allowance under section 32 AD cannot be claimed for the same capital expenditure.)
- (ii) Once deduction is claimed under this section, the assessee shall not be allowed any deduction in respect of the specified business under section 10AA and sections 80HH to 80RRB for the same or any other assessment year. Readers must note that all other deductions under 80C to 80U can be claimed except deductions starting from Section 80HH to 80RRB. (For example, deduction under 80G, 80GGA, 80GGB etc., can be claimed)
- (iii) Further, loss from specified business shall not be set off except against profits and gains of any other specified business. Any unabsorbed loss from specified business shall be carried forward for indefinite period. After carry forward, the same shall be adjusted against profit of specified business only.
- (iv) For the purpose of set off of losses only, in respect of the business of hotels and hospitals, the word "new" has been removed from the definition of "specified business".
As a result, any (old) hotel of two star above or any (old) hospital having atleast 100 beds for patients will qualify as specified business for the purpose of set off of losses.

Practical 9

XYZ Ltd. commenced operations of the business of a new three-star hotel in Madurai, Tamil Nadu on **1.4.2018**. The company incurred capital expenditure of Rs. 50 lakh during the period **January, 2018 to March, 2018** exclusively for the above business, and capitalized the same in its books of account as on **1st April, 2018**. Further, during the **P.Y.2018-19**, 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.2019-20**, assuming that XYZ Ltd. has fulfilled all the conditions specified for claim of deduction under section 35AD. The profits from the business of running this hotel (before claiming deduction under section 35AD) for the **A.Y.2019-20** is Rs. 25 lakhs. Assume that the company also has another existing business of running a four-star hotel in Coimbatore, which commenced operations few years back (time when section 35AD was not there in Income Tax Act, 1961), the profits from which are Rs. 120 lakhs for the **A.Y.2019-20**.

Solution

Particulars	Rs. In Lakhs	Rs. In Lakhs
Profits from the specified business of new hotel in Madurai (before providing deduction under section 35AD)		25
Less: Deduction under section 35AD		
Capital expenditure incurred during the P.Y.2018-19 (excluding the Expenditure incurred on acquisition of land)	50	
Capital expenditure incurred prior to 1.4.2018 (i.e., prior to commencement of business) and capitalized in the books of account as on 1.4.2018	50	
Total deduction under section 35AD for A.Y.2019-20		100
Loss from the specified business of new hotel in Madurai		(75)
Profit from the existing business of running a hotel in Coimbatore		120
Net profit from business after set-off of loss of specified business		45

Note:- In respect of the business of hotels and hospitals, the word “new” has been removed from the definition of “specified business”. Therefore, four star hotel at Coimbatore also fall within the definition of “specified business”.

Consequently, the loss of hotel at Madurai can be set-off against the profit of another specified business under section 73A.

Reader's Note:**B. Other Consequences of Claiming Deduction under section 35AD**

- (a) An asset (in respect of which a deduction has been claimed and allowed under section 35AD) shall be used only for the specified business for a period of 8 years beginning with the previous year in which such asset is acquired or constructed.
- (b) If such asset is used for any purpose other than the specified business during the abovementioned 8 years, then following shall be deemed to be income of the assessee of the previous year in which the asset is so used. [Section 35AD(7B)]

Particulars	Rs. in lakhs
Total amount of deduction claimed under section 35AD	XXXXX
Less: Amount of depreciation allowable in accordance with the provisions of section 32, as if no deduction had been allowed u/s 35AD	(XXX)
Deemed income under section 35AD (7B)	XXXXX

- (c) However, this provision will not apply to a company which has become a sick industrial company, under section 17(1) of the Sick Industrial Companies (Special Provisions) Act within the time period of abovementioned 8 years.
- (d) If any sum received or receivable on account of any capital asset, in respect of which deduction has been claimed under section 35AD, being demolished, destroyed, discarded or transferred then same shall be treated as income and chargeable to tax under the head "Profits and gains of business or profession". [Section 28(vii)]

Practical 10

ABC Ltd. set up warehousing unit for storage of agricultural produce on 10.06.2016. The construction cost of warehouse was Rs. 75 lacs on which weighted deduction (150%) was claimed under section 35AD. However, it started using this warehouse for storage of edible oils with effect from 01.04.2018. Discuss tax consequences for the assessment year 2019-20 in the hands of ABC Ltd.

Solution

Since the warehouse of specified business has been used for non-specified business (for storage of edible oils) in the **P.Y.2018-19**, the deeming provision under section 35AD(7B) shall be applicable.

Particulars	Rs.
Total amount of deduction claimed under section 35AD [150% of Rs. 75 Lacs)	1,12,50,000
Less: Depreciation allowable u/s 32 (Refer working note)	14,25,000
Deemed income under section 35AD(7B)	98,25,000

Working Note: Computation of depreciation allowable under section 32 for earlier years had deduction under 35AD not claimed.

Particulars	Rs.
Cost of Building	75,00,000
Less: Depreciation for the previous year 2016-17 [10%]	7,50,000
	67,50,000
Less: Depreciation for the previous year 2017-18 [10%]	6,75,000
	60,75,000
Total Depreciation [Rs.7,50,000 + Rs.6,75,000]	14,25,000

Reader's Note:

5.5 AMORTISATION OF PRELIMINARY EXPENSES

Section:- 35D

(1) Eligible Assessee

Indian company or a non-corporate resident assessee

(2) Time and purpose of incurring preliminary expenses:

Time of Incurring expenses	Purpose of expenses
Before commencement of business	For setting up of any undertaking or business
After commencement of business	Extension of the undertaking or setting up new unit

(3) List of specified expenditure

The work shall be carried on by the assessee itself or by a concern approved by the Board	The work can be carried on by the assessee itself or by any concern (approved or not approved)
Expenditure in connection with :- • preparation of feasibility report, • preparation of project report, • conducting a market survey or • engineering services relating to the business of the assessee.	• Legal charges for drafting any agreement between the assessee and any other person relating to the setting up of the business of the assessee. • Legal charges for drafting the memorandum and articles of association if the taxpayer is a company. • Printing expenses of the memorandum and articles of association if the taxpayer is a company. • Registration fee of a company under the provisions of the Companies Act.

	- Expenses in connection with the public issue of shares or debentures of a company, underwriting commission, brokerage and charges for drafting, typing, printing and advertisement of the prospectus. - Any other expenditure which may be prescribed.

(4) Maximum qualifying expenditure:

In the case of a corporate assessee	In the case of a non-corporate assessee
a. 5 per cent of cost of project; or b. 5 per cent of capital employed, whichever is more	5 per cent of cost of project

(5) Quantum of Deduction

The maximum qualifying expenditure as computed above will be allowed as a deduction in 5 equal installments starting from the previous year in which the business commences.

(6) Meaning of certain terms**(a) Capital employed**

- It is the aggregate of the issued share capital, debentures and long-term borrowings, as on the last day of the previous year in which the business of the company commences.
- Long-term borrowings - The term "long-term borrowing" in the above context, includes following—

<i>From whom borrowed?</i>	<i>Time period in which the loan is repayable</i>
Any money borrowed by the company from the (a) Government or (b) the Industrial Finance Corporation or India or (c) the Industrial Credit and Investment Corporation of India or (d) any other financial institution which is eligible for deduction u/s 36(1)(viii) or (e) any banking institution	No time period prescribed.
Any money borrowed or debt incurred by the company in foreign country in respect of purchases outside India of capital plant and machinery	Repayable for a period of not less than 7 years

(b) Cost of the project

It means the actual cost of fixed assets namely, land, buildings, leaseholds, plant, machinery, furniture, fittings and railway sidings (including expenditure on development of land and buildings), which are shown in the books of the assessee as on the last day of the previous year in which the business of the assessee commences.

(7) Audit Report

In case of non-corporate assesses, the assessee is required to furnish the audit report in Form 3B along with the return of income for the first year.

Practical 11

Vita biscuit Limited (VBL) was incorporated on **1st November, 2017**. However, it started commercial production on **14th February, 2019**. VBL incurred following preliminary expenses before commencement:

- (a) registration fees for incorporation : Rs. 20,000 ;
- (b) legal charges for drafting the memorandum, articles and prospectus etc. : Rs. 50,000 ;
- (c) printing expenses of memorandum, articles, prospectus, etc. : Rs. 30,000 ;
- (d) Advertisements expenses for issue of shares : Rs. 1,00,000;
- (e) Underwriting commission for issue of shares : Rs. 3,75,000 ;
- (f) Expenditure on preparation of feasibility report (the work is undertaken by the VBL) : Rs. 75,000 ;
- (g) Expenditure on preparation of the project report(the work is undertaken by an approved concern):Rs. 50,000;
- (h) Expenditure on conducting market survey necessary (the work is undertaken by a concern which is not approved for this purpose) :Rs. 85,000;
- (i) Legal charges for foreign collaboration agreement : Rs. 2,00,000 ;
- (j) Expenditure on engineering services in connection with the erection of plant and machinery : Rs. 3,50,000.

Following is the extract of balance sheet of VBL

	On March 31, 2018 (Rs.)	On March 31, 2019 (Rs.)
Cost of fixed assets (excluding engineering services)	17,00,000	1,32,50,000
Issued share capital	1,00,000	1,50,00,000
Paid up share capital	1,00,000	1,30,00,000
Debentures	10,00,000	10,00,000
Long-term borrowing in foreign country	9,00,000	15,00,000

Determine the amount deduction under section 35D.

Solution

Step 1: Total Qualifying Amount

Particulars	Rs.
Registration fees	20,000
Legal charges for darting	50,000
Printing expenses	30,000
Advertisement expenses	1,00,000
Underwriting Commission	3,75,000
Expenditure on preparation of feasibility report	75,000
Expenditure on preparation of project report	50,000
Expenditure on conducting market survey (not eligible as the work is undertaken by an unapproved concern)	Nil
Legal Charges for foreign collaboration agreement	2,00,000
Expenditure on engineering services (it is beneficial to capitalize)	Nil
Total Qualifying Amount	9,00,000

Step 2: Limit on Total Qualifying Amount is higher of the following

- (1) 5% of Cost of the project on **March 31, 2019**
 $5\% (\text{Rs. } 1,32,50,000 + \text{Rs. } 3,50,000 = \text{Rs. } 1,36,00,000 \times 5\%)$
 Rs. 6,80,000
- (2) 5% of Capital Employed on **March 31, 2019**
 $5\% \text{ of (i.e., Rs. } 1,50,00,000 + \text{Rs. } 10,00,000 + \text{Rs. } 15,00,000 = \text{Rs. } 1,75,00,000)$
Rs. 8,75,000

Step 3: Maximum Qualifying Amount is lower of

Step 1: Rs. 9,00,000

Step 2: **Rs. 8,75,000**

Step4: Amount of deduction under section 35D = step 3 / 5 years

= Rs.8,75,000 / 5 years

= Rs.1,75,000

Above amount is to be allowed as deduction u/s. 35D beginning with the previous year in which assessee commences business i.e. **previous year 2018-19**.

Reader's Note:

(8) How to compute deduction under section 35D in case of extension of undertaking

(a) Meaning of capital employed:

It is the aggregate of issued share capitals debentures and long-term borrowing as on the last day of the previous year in which the extension of undertaking is completed or, as the case may be, the new industrial unit commences production or operation, insofar as such capital, debentures and long-term borrowings have been issued or obtained in connection with the extension of the undertaking or the setting up of the new industrial unit of the company.

(b) Meaning of Cost of project

The cost of project is defined to mean the actual cost of fixed assets, as stated above, which are shown in the books of the assessee as on the last day of the previous year in which the extension of undertaking is completed, or, as the case may be, the new unit commences production or operation in so far as such fixed assets have been acquired or developed in connection with the extension of the undertaking or setting up of the new unit of the assessee.

In case of extension of undertaking, deduction shall be allowed in 5 equal installments starting from the previous year in which extension of undertaking is completed.

5.6 DEDUCTION FOR PROVISION FOR BAD AND DOUBTFUL DEBTS IN CASE OF CERTAIN ASSESSEE

Section:- 36(1)(viiia)

Assessee	Amount of Deduction	Additional Deduction in case of Rural Branches	Additional Optional deduction
Any Scheduled, Non-Scheduled or co-operative bank but other than a primary agriculture credit society or a primary co-operative agricultural and rural development bank (Except Foreign Bank)	Not exceeding 8.5% of its total income*	10% of aggregate average advances made by rural branches of Bank.	Further deduction of an amount not exceeding the income derived from redemption of securities in accordance with scheme framed by Government. However, this additional deduction can be claimed only if income from such securities has been offered for taxation under the head "Profits and Gains of Business or Profession".
Any Foreign Bank			
Public Financial Institution or State Financial Corporation or State Industrial Investment Corporation or NBFC	5% of its total income*	Not available	Not available

*Total Income means total income before claiming deduction under this clause and Chapter VIA

Notes:

In the case of an assessee to which section 36(1)(viiia) applies, the amount of the deduction relating to any bad debt or part thereof under section 36(1)(vii) shall be limited to the amount by which such debt or part thereof exceeds the credit balance in the provision for bad and doubtful debts account made under section 36(1) (viiia) **without making any distinction between rural advances and other advances.**

That means, there should be only **one account in respect of provision for bad and doubtful debts** without making any distinction between rural advances and other advances.

Practical 12

The following are the particulars in respect of Indian Bank

Sr. No.	Particulars	Rs. in lakhs
(i)	Provision for bad and doubtful debts u/s 36(1)(viiia) as on 1st April 2018	200
(ii)	Gross Total Income of A.Y.2019-20 [before deduction u/s 36(1)(viiia)]	1000
(iii)	Aggregate average advances made by rural branches of the bank (assume that bank opened first time rural branches in previous year 2018-19).	400
(iv)	Bad debts written off (for the first time) in the books of account (in respect of urban advances only) during the previous year 2018-19	350

Compute deduction:

- (a) in respect of provision for bad and doubtful debt under section 36(1) (viiia)
- (b) in respect of bad debts under section 36(1)(vii)

Solution

- (a) Deduction in respect of provision for bad and doubtful debt under section 36(1) (viiia) = Rs. 85 lacs + Rs. 40 Lacs = Rs. 125 Lacs
- (b) Deduction in respect of bad debts under section 36(1) (vii) = Rs. 25 Lacs

Working Note:

Provision for Bad-Doubtful Debts A/c [ONE/SINGLE ACCOUNT]

Dr.		Cr.	
Particulars	Rs. in lakhs	Particulars	Rs. in lakhs
		By Balance b/f	200
		By Profit & Loss A/c [1000 x 8.5%]	85
To Debtors A/c	325	By Profit & Loss A/c [400 x 10%]	40
	325		325

Bad-Debts A/c

Dr.		Cr.	
Particulars	Rs. in lakhs	Particulars	Rs. in lakhs
To Debtors A/c [350-325]	25	By Profit & Loss A/c	25
	25		25

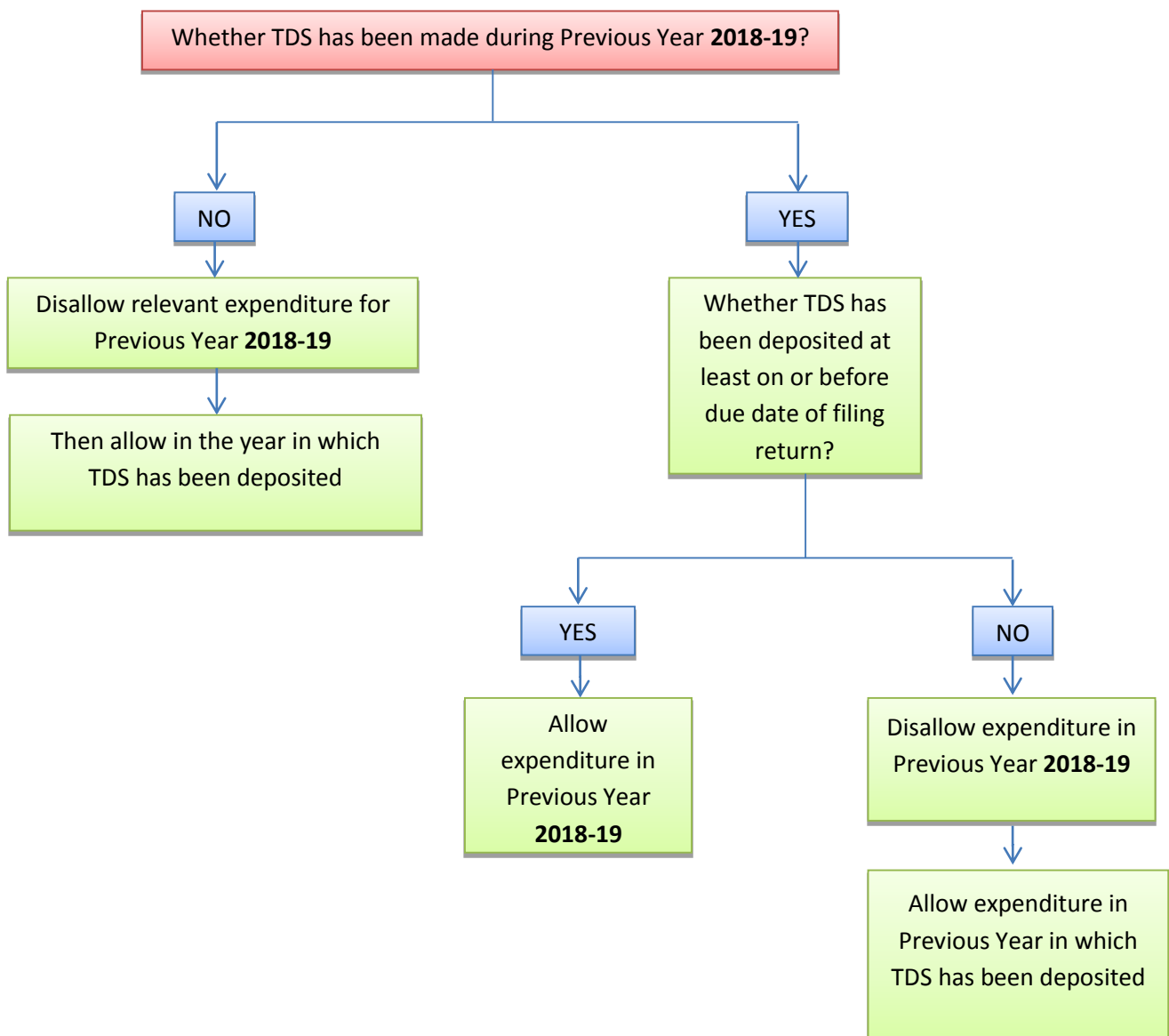
Reader's Note:

5.7 MARKED TO MARKET LOSS or EXPECTED LOSS**Section:-** 36(1)(xviii) – Inserted by Finance Act, 2018 w.r.e.f. 2017-18

Marked to market loss or other expected loss computed in accordance with the ICDS.

Practical 13

Explain the meaning of marked to market loss & also discuss its allowability under the Income Tax Act.

UNIT B – SPECIFIC DISALLOWANCES**5.8 INTEREST, ROYALTY, FEES FOR TECHNICAL SERVICES PAYABLE OUTSIDE INDIA OR PAYABLE TO NON-RESIDENTS****Section:-** 40(a)(i)**Summary :- Payment to Non-Resident other than Salary [Section 40(a) (i)]**

Practical 14

Discuss tax consequences under section 40 (a) (i).

- (a) A consultancy fees of Rs. 40,000 is credited by X Ltd. to the account of non-resident payee on **1st February, 2019** but tax was deducted on **April 1, 2019** and it is deposited on **May 2, 2019**. Due date of filing return for X Ltd. is **September 30, 2019**.
- (b) Interest of Rs. 80,000 on debenture is paid by Y Ltd. on **January 10, 2019** to the account of non-resident payee. Tax is deducted on the same day. Tax is deposited on **August 10, 2019**. Due date of filing return for Y Ltd. is **September 30, 2019**.
- (c) Suppose in point no.(b) above, tax is deposited on **October 10, 2019**.

Solution

- (a) In this case, X Ltd failed to deduct TDS during previous year **2018-19**, therefore, consultancy fee of Rs. 40,000 shall be first disallowed for the previous year **2018-19** and same shall be allowed as deduction in the year in which TDS has been deposited i.e. in previous year **2019-20**.
- (b) In this case, Y Ltd. has deducted TDS during previous year **2018-19** and further, same has been deposited on or before due date of filing return under section 139(1), therefore, interest of Rs. 80,000 paid to non-resident shall be allowed as deduction during previous year **2018-19** itself.
- (c) In this case, Y Ltd. though deducted TDS during previous year **2018-19** but failed to deposit the same on or before due date of filing return under section 139(1), therefore, interest expense of Rs. 80,000 shall be first disallowed for the previous year **2018-19** and same shall be allowed as deduction in the year in which TDS has been deposited. i.e. in previous year **2019-20**.

Reader's Note:

‡ **Circular No. 3/2015, dated 12-02-2015** ‡

Clarification regarding disallowance of 'other sum chargeable' under section 40(a)(i)

If there has been a failure in deduction or in payment of tax deducted in respect of any interest, royalty, fees for technical services or other sum chargeable under the Act either payable in India to non-corporate non-resident or a foreign company or payable outside India, then, disallowance of the related expenditure/ payment is attracted under section 40(a)(i) while computing income chargeable under the head "Profits and gains of business or profession".

The interpretation of the term 'other sum chargeable' in section 195 has been clarified in this circular i.e. whether this term refers to the whole sum being remitted or only the portion representing the sum chargeable to income-tax under the Act.

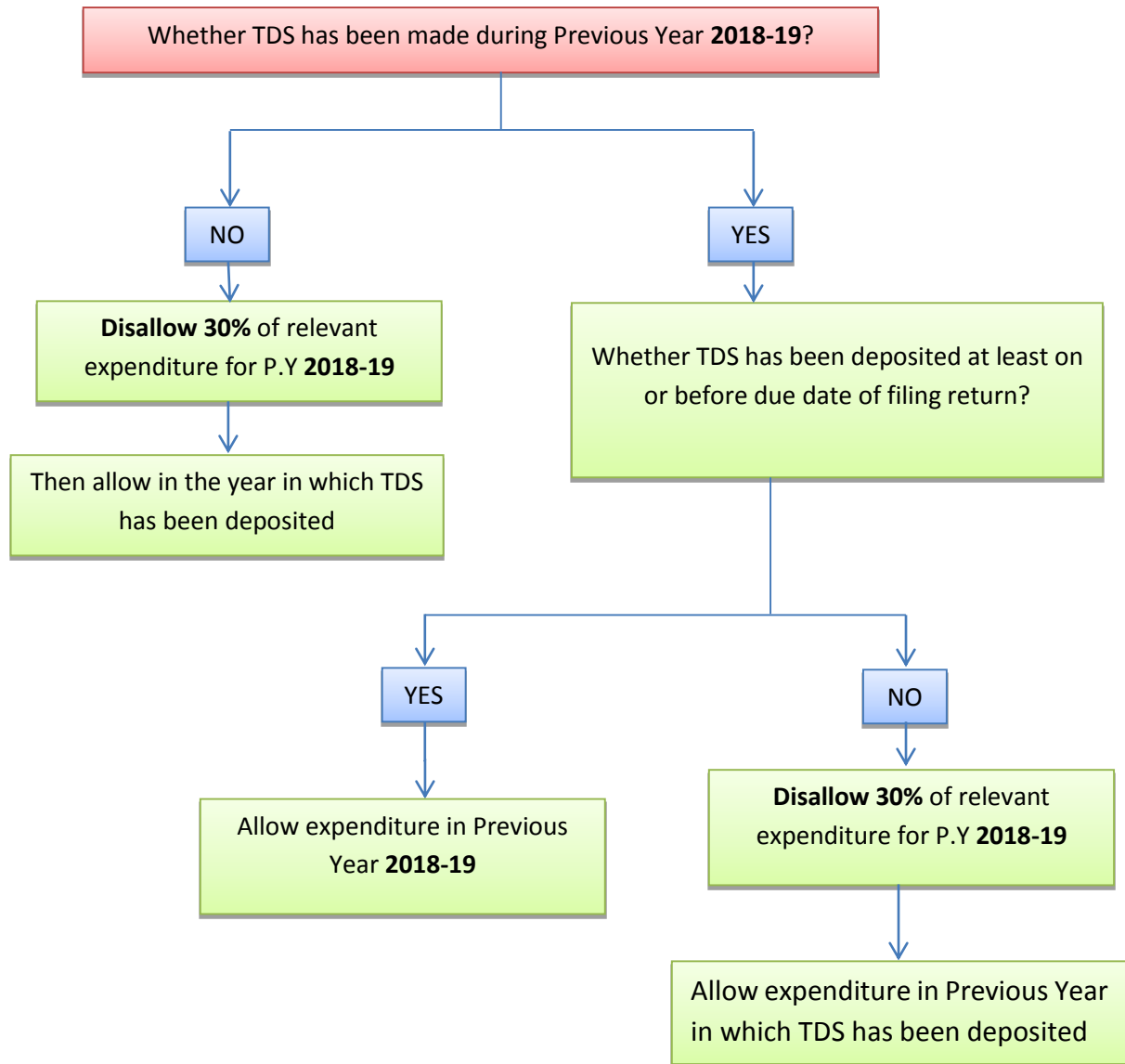
In its Instruction No. 2/2014, dated 26.02.2014, the CBDT has clarified that the Assessing Officer shall determine the appropriate portion of the sum chargeable to tax as mentioned in section 195(1), to ascertain the tax liability on which the deductor shall be deemed to be an assessee in default u/s 201, in cases where no application is filed by the deductor for determining the sum so chargeable u/s 195(2).

In this circular, the CBDT has, in exercise of its powers under section 119, clarified that for the purpose of making disallowance of 'other sum chargeable' under section 40(a)(i), the appropriate portion of the sum which is chargeable to tax shall form the basis of disallowance. Further, the appropriate portion shall be the same as determined by the Assessing Officer having jurisdiction for the purpose of section 195(1). Also, where the determination of 'other sum chargeable' has been made under sub-section (2), (3) or (7) of section 195 of the Act, such a determination will form the basis for disallowance, if any, under section 40(a)(i).

5.9 ANY SUM PAYABLE TO RESIDENT

Section:- 40(a)(ia)

Summary :- Any Payment to Resident [Section 40(a)(ia)]

**Practical 15**

Discuss tax consequences under section 40 (a) (ia).

- A consultancy fees of Rs. 40,000 is credited by X Ltd. to the account of resident payee on **1st February, 2019** but tax was deducted on **April 1, 2019** and it is deposited on **May 2, 2019**. Due date of filing return for X Ltd. is **September 30, 2019**.
- Interest of Rs. 80,000 on debenture is paid by Y Ltd. on **January 10, 2019** to the account of resident payee. Tax is deducted on the same day. Tax is deposited on **August 10, 2019**. Due date of filing return for Y Ltd. is **September 30, 2019**.
- Suppose in point no.(b) above, tax is deposited on **October 10, 2019**.
- Salary of Rs. 12,00,000 was paid to executive director (resident) of Z Ltd. during previous year **2018-19** without deducting TDS.

Solution

- (a) In this case, X Ltd failed to deduct TDS during previous year **2018-19**, therefore, 30% consultancy fee of Rs. 40,000 (Rs. 12,000) shall be first disallowed for the previous year **2018-19** and same shall be allowed as deduction in the year in which TDS has been deposited i.e. in previous year **2019-20**.
- (b) In this case, Y Ltd. has deducted TDS during previous year **2018-19** and further, same has been deposited on or before due date of filing return under section 139(1), therefore, interest of Rs. 80,000 paid to the resident shall be allowed as deduction during previous year **2018-19** itself.
- (c) In this case, Y Ltd. though deducted TDS during previous year **2018-19** but failed to deposit the same on or before due date of filing return under section 139(1), therefore, 30% interest expense of Rs. 80,000 (Rs.24,000) shall be first disallowed for the previous year **2018-19** and same shall be allowed as deduction in the year in which TDS has been deposited. i.e. in previous year **2019-20**.
- (d) Section 40(a)(ia) is applicable to **any sum payable to resident** (which includes salary also). Since Z Ltd. had not deducted tax at source, it will attract disallowance of Rs. 3,60,000 (30% of Rs. 12,00,000) for the previous year **2018-19** while computing its income under head "Profits and gains from business or profession".

Reader's Note:**5.10 SALARY PAYABLE OUTSIDE INDIA OR PAYABLE TO NON-RESIDENTS****Section:- 40(a)(iii)**

In this case, verify that

- (a) Either TDS has been deducted

OR

TDS has been deposited

If any of the above (a) or (b) is satisfied then, allow salary expenditure in the previous year to which it pertains **(Previous year 2018-19)**.

Practical 16

Fill in the last column considering the provisions of section 40(a)(iii) of Income Tax Act, 1961 assuming that payment is made by a company to (a) any person outside India or (b) non-resident in India –

Amount Rs. (Salary for the Previous year 2018-19)	Actual date of tax deduction	Actual date of tax deposit	Previous year in which salary payment is deductible
90,000	March 31, 2019	April 7, 2019	
1,60,000	March 31, 2019	May 12, 2019	
70,000	Not deducted	May 12, 2019	
75,000	March 31, 2019	Not deposited	
95,000	Not deducted	Not deposited	

Solution

Amount of Salary	Previous year in which salary payment is deductible
90,000	2018-19
1,60,000	2018-19
70,000	2018-19
75,000	2018-19
95,000	No deduction

Reader's Note:

5.11 TAX ON NON-MONETARY PERQUISITES**Section:-** 40(a)(v) and 10(10CC)

- (1) Any obligation of employee which has been met by employer is treated as perquisite and therefore it shall be added to the salary income of employee.
- (2) On the basis of same reasoning, income tax liability of employee which has been met by employer shall be treated as perquisite and therefore added to salary.
- (3) However, as per Section 10 (10CC) if income tax is borne by employer in respect of non-monetary perquisite, then such tax (though borne by employer) shall not be added to salary income.
- (4) However, there is a punishment to employer under section 40(a)(v). As per this section employer will not get deduction of tax so borne while computing his PGBP income.

Practical 17

Mr. Jabanz, an employee of Himmat Software Private Limited (HSPL), provides following information:

- (a) Salary : Rs. 50,000 p.m.
- (b) Employer had taken unfurnished house property on monthly lease of Rs. 12,000 and provided the same to Mr. Jabanz as rent-free unfurnished accommodation,
- (c) It was agreed that the tax on above perquisite is to be borne by employer

You are required to compute tax liability of Mr. Jabanz.

Further, discuss tax consequences of above transactions in the hands of Himmat Software Private Limited.

Solution**Computation of total income and tax liability in the hands of Mr. Jabanz**

Particulars	Rs.
Salary	6,00,000
Value of rent free accommodation (15% of salary or lease rent paid whichever is lower)	90,000
Tax borne by Employer on rent- free accommodation [Exempt under section 10(10CC)]	NIL
Total Income	6,90,000
Tax on total income (A)	52,520
Average rate of tax (Rs. 52,520 / Rs. 6,90,000 x 100) :	7.6116%
Tax on perquisite (7.6116% of Rs. 90,000) (B)	(3,998)
Net Tax Payable (A-B)	48,522

Tax consequences of following payments in the hands of Himmat Software Private Limited:

Particulars	Rs.	Tax Treatment under head PGBP
Salary to Mr. Jabanz	6,00,000	Deductible under section 37(1)
Lease rent paid	1,44,000	Deductible under section 30/37(1)
Tax on perquisite borne by HSPL.	3998	Not deductible due to section 40(a)(v)

Reader's Note:

5.12 PAYMENT EXCEEDING RS.10,000 MADE OTHERWISE THAN BY ACCOUNT PAYEE CHEQUE OR DEMAND DRAFT

Section:- 40A(3)

- (1) Where the assessee incurs any expenditure in respect of which a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque or account payee bank draft or use of electronic clearing system through a bank account, exceeds ten thousand rupees, no deduction shall be allowed in respect of such expenditure.
- (2) However, in the case of payment made for plying, hiring or leasing goods carriages, the monetary limit of Rs.35,000 shall be applicable while giving effect to the provisions of this section.
- (3) The provisions of this section shall be applicable to all types of expenditure including payment made for purchase of goods which are to be claimed under the head "PGBP".
- (4) However, no disallowance shall be made under this sub-section, in such cases and under such circumstances as may be prescribed, having regard to the nature and extent of banking facilities available, considerations of business expediency and other relevant factors.
- (5) Circumstances prescribed under Rule 6DD, for which no disallowance shall be made under this section, are as under:

(a)	Payment made to the Reserve Bank of India or any banking company or State Bank of India or any subsidiary bank or any co-operative bank or land mortgage bank or any primary agricultural credit society or any primary credit society.
(b)	Payment made to Government and as per rules such payment is required to be made in legal tender
(c)	Payment through banking system e.g. (i) any letter of credit (ii) a mail or telegraphic transfer (iii) book adjustment from any account in a bank to any other account in that or any other bank (iv) bill of exchange (v) The use of electronic clearing system through a bank account (vi) A credit card; (vii) A debit card.
(d)	where the payment is made by way of adjustment against the amount of any liability incurred by the payee for any goods supplied or services rendered by the assessee to such payee;
(e)	Where the payment is made for the purchase of— (i) Agricultural or forest produce; or (ii) The produce of animal husbandry (including livestock, meat, hides and skins) or dairy or poultry farming; or (iii) Fish or fish products; or (iv) The products of horticulture or apiculture, to the cultivator, grower or producer of such articles, produce or products; Circular No. 4 /2006 It is further clarified that benefit under this clause will not be available on the payment for the purchase of livestock, meat, hides and skins from a person who is not proved to be the producer of these goods and is only a trader, broker or any other middleman by whatever name called.

	Circular No. 8/2006 (a) The Board after examination of the issue is of the view that any person, by whatever name called, who buys animals from the farmers, slaughters them and then sells the raw meat carcasses to the meat processing factories or to the traders/retail outlets would be considered as producer of livestock and meat. (b) The benefit of rule 6DD of the Income-tax Rules, 1952 shall be available to the person referred to at para (a) above subject to furnishing of the following :— (i) A declaration from the person receiving the payment that he is a producer of meat; (ii) A confirmation that the payment, otherwise than by an account payee cheque or account payee bank draft, was made on his insistence; and (iii) A further confirmation from a veterinary doctor certifying that the person specified in the certificate is a producer of meat and that slaughtering was done under his supervision.
(f)	Where the payment is made for the purchase of the products manufactured or processed without the aid of power in a cottage industry, to the producer of such products;
(g)	Where the payment is made in a village or town, which on the date of such payment is not served by any bank, to any person who ordinarily resides, or is carrying on any business, profession or vocation, in any such village or town;
(h)	Where any payment is made to an employee of the assessee or the heir of any such employee, on or in connection with the retirement, retrenchment, resignation, discharge or death of such employee, on account of gratuity, retrenchment compensation or similar terminal benefit and the aggregate of such sums payable to the employee or his heir does not exceed fifty thousand rupees;
(i)	Payment made by an assessee by way of salary to his employee after deducting tax from salary in accordance with the provisions of section 192 and when such employee- (a) is temporarily posted for a continuous period of 15 days or more in a place other than his normal place of duty or on a ship and (b) does not maintain any account in any bank at such place or ship.
(j)	Where the payment was required to be made on a day on which the banks were closed either on account of holiday or strike;
(k)	Where the payment is made by any person to his agent who is required to make payment in cash for goods or services on behalf of such person;
(l)	Where the payment is made by an authorised dealer or a money changer against purchase of foreign currency or travellers cheques in the normal course of his business.

5.13 MARKED TO MARKET LOSS OTHER THAN UNDER SECTION 36(1)(xviii)

Section:- 40A(13) - Inserted by Finance Act, 2018 w.r.e.f. A.Y. 2017-18

No deduction or allowance shall be allowed in respect of any marked to market loss or other expected loss except as allowable under section 36(1)(xviii).

5.14 CERTAIN DEDUCTIONS TO BE ONLY ON ACTUAL PAYMENT**Section:- 43B**

- Followings are deductible on payment basis:
 - (a) Any sum payable by way of tax, duty, cess or fees by whatever name called under any law for the time being in force e.g. Municipal tax, Excise Duty, VAT, Service Tax, Custom Duty
 - (b) Any sum payable by an employer by way of contribution to provident fund or superannuation fund or any other fund for the welfare of employees. **(Employers' Contribution)**
 - (c) Any sum payable as bonus or commission to employees.
 - (d) Any sum payable as interest on any loan or borrowing from a public financial institution or a state financial corporation or a state industrial investment corporation.
 - (e) Interest on any loan or advances taken from a scheduled bank or a co-operative bank other than a primary agriculture society or a primary co-operative agricultural and rural development bank.
 - (f) Any sum payable by an employer in lieu of leave at the credit of his employee
 - (g) any sum payable by the assessee to the Indian Railways for the use of railway assets.
- Above expenditures are deductible in the previous year in which they have been incurred provided actual payment has been made on or before the due date for furnishing return of income u/s 139(1).
- If payment is not made within the time mentioned above, then relevant expenditure is first disallowed and thereafter it shall be allowed as deduction in the previous year in which actual payment is made.
- Explanation 3C and 3D of section 43B**

If any sum payable by an assessee as interest on any loan or borrowing or advance is converted by the bank or financial institution into a fresh loan, the interest so converted (but not actually paid) shall not be deemed to have been actually paid for the purpose of this section and therefore same shall not be allowed as deduction under the head PGBP.
- Further, student must note that **Employees' Contribution** is not governed by section 43B. It is governed by section 2(24) & section 36(1)(va). Tax treatment of Employees' Contribution is as under:-

N.P. as per profit and loss account	XXX
Add: Employees' Contribution :- It is deemed income as per definition of Income [Section 2(24) (x)]	XXX
Less: Amount deposited within the due date under Provident Fund Act or any other relevant Act [Section 36(1)(va)]	XXX

UNIT C- DEEMED INCOME UNDER "PGBP"**5.15 SECTION 41****Sub - Section:- (1)**

To whom it is applicable?	Particulars of deemed receipt
All assesses including successor of business	<i>Condition one</i> - In any of the earlier years, a deduction was allowed in respect of loss, expenditure or trading liability incurred by the assessee. <i>Condition two</i> - During the current previous year, the assessee—

	a. has obtained in cash or any other manner, any amount in respect of such loss, expenditure or trading liability (to be called refund or recovery); Or b. has obtained some benefit in respect of such trading liability by way of remission or cessation thereof [Explanation 1-“remission or cessation” for this purpose includes unilateral act of the assessee by way of writing off of such liability in his books of account]. If the above two conditions are satisfied, the amount obtained by such person or the value of benefit accruing to him shall be deemed to be profits and gains of business or profession and accordingly chargeable to tax as the income of that previous year.

5.16 SPECIAL PROVISIONS CONSEQUENTIAL TO CHANGES IN RATE OF EXCHANGE OF CURRENCY

Section:- 43A

Where an assessee acquires an asset from abroad and in consequence of the variation in exchange rate, the liability of the assessee in terms of payment towards the acquisition of that asset increases or decreases, then the actual cost of that asset shall be increased or decreased for the following sections:

- Section 43(1)
- Section 35(1)(iv)
- Section 36(1)(ix)
- Section 48.

However, the abovementioned increase or decrease in liability due to exchange rate fluctuation shall be taken into account at the time of making payment, irrespective of method of accounting followed by the taxpayer.

Explanation 1.—In this section, —

- (a) "rate of exchange" means the rate of exchange determined or recognised by the Central Government for the conversion of Indian currency into foreign currency or foreign currency into Indian currency;
- (b) "foreign currency" and "Indian currency" have the meanings respectively assigned to them in section 2 of the Foreign Exchange Management Act, 1999.

Explanation 2.—Where the whole or any part of the liability aforesaid is met, not by the assessee, but, directly or indirectly, by any other person or authority, the liability so met shall not be taken into account for the purposes of this section.

Explanation 3.—Where the assessee has entered into a contract with an authorised dealer for providing him with a specified sum in a foreign currency on or after a stipulated future date at the rate of exchange specified in the contract to enable him to meet the whole or any part of the liability aforesaid, the amount, if any, to be added to, or deducted from, the actual cost of the asset or the amount of expenditure of a capital nature or, as the case may be, the cost of acquisition of the capital asset under this section shall, in respect of so much of the sum specified in the contract as is available for discharging the liability aforesaid, be computed with reference to the rate of exchange specified therein.

Practical 18

Nicholas Manufacturing Ltd. purchased a machinery (eligible for depreciation at 15%) on credit from Germany for Euro 1,00,000 on **08.09.2017**. The exchange rate on the date of acquisition was Rs.73. The assessee made payment on **08.10.2018** and for that he took a forward exchange for that exchange rate specified in the contract was Rs.77 per Euro. Compute depreciation for the previous year **2017-18** and **2018-19**. Ignore additional depreciation.

Solution**Computation of depreciation for the assessment years 2017-18 and 2018-19**

	Rs.	Rs.
Cost of the asset [€1,00,000 x Rs.73]	73,00,000	10,95,000
Less: Depreciation for the previous year 2017-18 @15%	10,95,000	
WDV as on 1.4.2018	62,05,000	
Add: Exchange rate difference u/s 43A [€1,00,000 x Rs.4]	4,00,000	9,90,750
WDV for the previous year 2018-19	66,05,000	
Depreciation @15% for the previous year 2018-19	9,90,750	
WDV as on 1.4.2019	56,14,250	

Reader's Note:**5.17 TAXATION OF FOREIGN EXCHANGE FLUCTUATION****Section:-** 43AA – Inserted by Finance Act, 2018 , w.r.e.f. A.Y.2017-18

Section 43AA provides that any gain or loss arising on account of any change in foreign exchange rates shall be treated as income (or loss) and such income (or loss) shall be computed in accordance with ICDS notified under section 145(2).

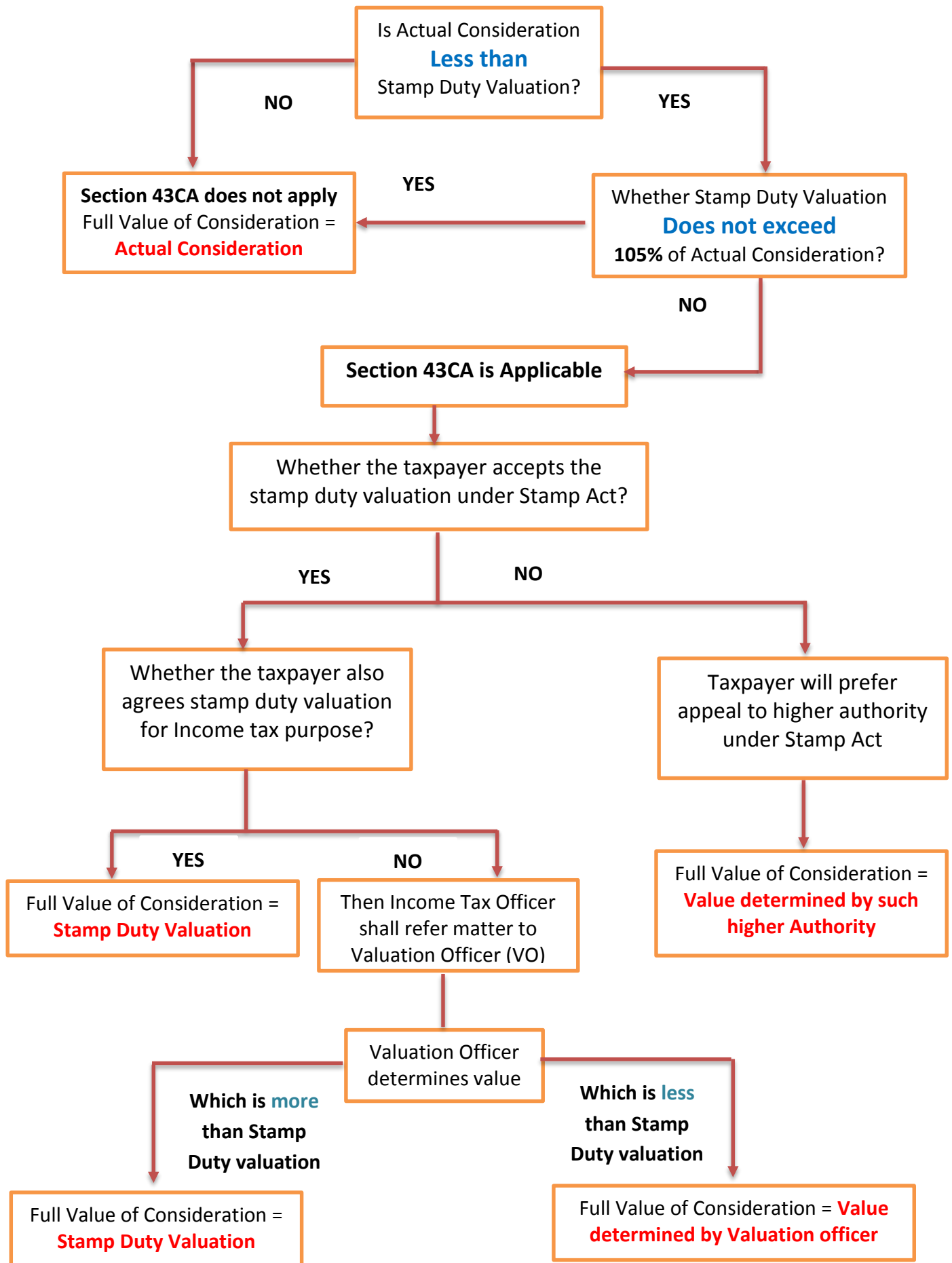
It further provides that gain (or loss) arising on account of the effects of change in foreign exchange rates shall be in respect of all foreign currency transactions including those relating to

- (a) monetary items and non-monetary items;
- (b) translation of financial statements of foreign operations;
- (c) forward exchange contracts;
- (d) foreign currency translation reserves.

Remark: The above provisions (of section 43AA) shall not be applicable where provisions of section 43A are applicable.

5.18 STAMP DUTY VALUE OF LAND AND BUILDING TO BE TAKEN AS THE FULL VALUE OF CONSIDERATION IN RESPECT OF TRANSFER, EVEN IF THE SAME ARE HELD BY THE TRANSFEROR AS STOCK-IN-TRADE**Section:-** 43CA

This section is applicable when consideration received on transfer of land or building or both is less than the value adopted by Stamp Authority for the purpose of payment of stamp duty. Consider the following chart:-



(1) Following proviso shall be inserted in sub-section (1) of section 43CA by the Finance Act, 2018, w.e.f. 1-4-2019:

Provided that where the value adopted or assessed or assessable by the authority for the purpose of payment of stamp duty does not exceed one hundred and five per cent of the consideration received or accruing as a result of the transfer, the consideration so received or accruing as a result of the transfer shall, for the purposes of computing profits and gains from transfer of such asset, be deemed to be the full value of the consideration. Readers must note that the effect of this proviso has already been incorporated in the chart discussed above.

(2) As per sub-section (3) and (4) of Section 43CA, if there is a time gap between date of agreement and date of registration, **the stamp duty value may be taken as on the date of agreement** instead of the date of registration.

However, for the same, at least a part of the consideration has been received ~~by any mode other than cash~~ **by way of an account-payee cheque or draft or by use of electronic clearing system through a bank account (substituted by Finance Act, 2018, w.e.f. A.Y. 2019-20)** on or before the date of agreement



SECTION 50C: For detailed discussion: Refer Module I – Chapter 6 -Capital Gains

Practical 19

M/s. Radheshyma Builders would like to sell the flats constructed by it. The valuation of one flat for the purpose of stamp duty is Rs. 25,00,000. Find out the revenue to be booked under the head PGBP under following alternatives, if actual consideration received by it is:

Alternative I	Alternative III	Alternative III
Rs.25,21,000	Rs.24,00,000	Rs.23,00,000

Solution

Alt ern ati ve	Actual Considerat ion (AC)	Stamp Duty Valuation (SDV)	Is AC <SDV?	If yes, then find out 105% of AC.	Whether SDV does not exceed 105% of AC?	Applicabi lity of section 43CA?	Revenue to be booked under the head PGBP
I	25,21,000	25,00,000	No	NA	NA	NA	AC=25,21,000
II	24,00,000	25,00,000	Yes	25,20,000	Yes	NA	AC=24,00,000
III	23,00,000	25,00,000	Yes	24,15,000	No	Yes	SDV=25,00,000

Reader's Note:

Practical 20

Rahul, a property dealer sold building to Shweta, details of which are as under:

1. Date of entering into agreement: **1.8.2017**.
2. Agreed consideration : Rs. 100 lakhs
3. Down payment of Rs. 5 lakhs was received by bearer cheque on the date of agreement.
4. Stamp duty value of the building on the date of agreement was Rs. 135 lakhs.
5. On receipt of balance payment, registration of sale deed took place on **1.1.2018**.
6. Stamp Duty value on the date of registration of sale deed was Rs. 145 lakhs.
7. Rahul has purchased this building for Rs. 65 Lakh on **12.07.2016**.

Discuss tax implication in the hands of Rahul,

- (a) Before the amendment made by Finance Act, 2018 under sub-section (4) of 43CA
- (b) After the amendment made by Finance Act, 2018 under sub-section (4) of 43CA

Solution**(a) Before the amendment made by Finance Act, 2018 under sub-section 4 of 43CA****Computation of taxable business income**

Particulars	Amount Rs. in lakhs	Remarks
Sale Consideration	135	As per Section 43CA(3)& (4), if there is a time gap between date of agreement and date of registration, the stamp duty value may be taken as on the date of agreement instead of the date of registration. However, for the same, at least a part of the consideration has been paid by any mode other than cash on or before the date of agreement.
Less: Purchase Price	65	-
Business Income	70	-

(b) After the amendment made by Finance Act, 2018 under sub-section 4 of 43CA**Computation of taxable business income**

Particulars	Rs. in lakhs	Remarks
Sale Consideration	145	The amendment made by Finance Act, 2018 under section 43CA(4) gives an option to adopt stamp duty value on the date of registration provided some consideration has been received by way of an account payee cheque or account payee bank draft or by use of electronic clearing system through a bank account, on or before the date of the agreement Readers shall pay attention to the fact that Rahul received bearer cheque. Therefore, he cannot take advantage of stamp duty on date of agreement due to above amendment.
Less: Purchase Price	65	-
Business Income	80	-

Reader's Note:**5.19 COMPUTATION OF INCOME FROM CONSTRUCTION AND SERVICE CONTRACTS****Section:- 43CB – Inserted by Finance Act, 2018 w.r.e.f. A.Y. 2017-18**

- Section 43CB (1) provides that the profits and gains arising from (i) a construction contract or (ii) a contract for providing services shall be determined on the basis of percentage of completion method in accordance with the ICDS
- It further provides that profits and gains arising from a contract for providing services -
 - with duration of not more than 90 days shall be determined on the basis of project completion method.
 - involving indeterminate number of acts over a specific period of time shall be determined on the basis of straight line method.
- Section 43CB (2) provides that for the purpose of project completion method or straight line method
 - the contract revenue shall include retention money.
 - the contract costs shall not be reduced by any incidental income in the nature of interest, dividends or capital gains.

Practical 21

Vrindavan Construction Private Limited undertaken a construction contract on 01/04/2017. The fixed contract price agreed was Rs. 2,00,00,000 (including retention money Rs. 10,00,000). The company incurred Rs. 81,00,000

in previous year 2017-18 for 45% work and received Rs. 79,00,000 as progress payment from the customer. The cost incurred in previous year 2018-19 was Rs. 89,00,000 to complete the rest of work. During previous year 2018-19 company also earned a small gain of Rs. 88,000 on disposal of plant specifically purchased for this contract. Besides, company recovered interest of Rs. 1,12,000 on advances made to sub-contractor for this contract.

You are required to ascertain:

- Contract Revenue
- Contract Cost for the previous year 2017-18 and 2018-19
- Profit to be recognized for the previous year 2017-18 and 2018-19 from this construction contract.

UNIT E - MAINTENANCE OF ACCOUNTS, PRESUMPTIVE TAXATION AND TAX AUDIT

5.20 PROVISIONS IN RELATION TO MAINTENANCE OF BOOKS OF ACCOUNTS UNDER INCOME TAX ACT

Section:- 44AA

The requirement of this section regarding maintenance of books of account by certain persons are based on two criteria:

- Financial criteria;
- Persons specified under Section 44AA (1).

Accordingly, the requirement of keeping books of account shall be as under:

Types of profession/Business	Financial criteria	Books of account / documents to be maintained
Specified professions u/s 44AA(1)	- Total gross receipts exceed Rs.1,50,000 in any of the three years immediately preceding the previous year or - where the profession is newly set up in the previous year, total gross receipts are likely to exceed Rs.1,50,000.	Books and documents as prescribed under Rule 6F (2).
Specified professions u/s 44AA (1)	- Total gross receipt Rs.1,50,000 or below in any of the three years immediately preceding the previous year or - total gross receipts not likely to exceed Rs.1,50,000 in the previous year, if the profession is newly set up.	Such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance with the provision of the Act.
Other persons	- Income from business or profession exceeds Rs.1,20,000 or total sales, turnover or gross receipts exceed Rs.10 lakhs in any of the three years preceding the previous year or - Where the business or profession newly set up in the previous year, if his income from business or profession likely to exceed Rs. 1,20,000 or total sales, turnover or gross receipts likely to exceed Rs.10 lakhs, or	Such books of account and other documents as may enable the Assessing Officer to compute his total income in accordance with the provision of the Act.

	(c) In case of person being an individual or Hindu undivided family, the provisions of clause (a) and (b) above, the limit of Rs. 1,20,000 shall be substituted by Rs. 2,50,000 and the limit of Rs. 10 lakhs shall be substituted by Rs. 25 lakhs (Inserted by Finance Act, 2017 w.e.f. A.Y. 2018-19) or (d) where profits and gains from the business are claimed to be lower than profits computed under Section 44AE or 44BB or 44BBB or (e) Where the provisions of section 44AD(4) are applicable in his case and his income exceeds maximum amount not chargeable to tax in any previous year.	
Other persons	Not covered by above	Not required to maintain any books of account.

(1) Persons specified u/s 44AA (1): Every person carrying on legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or authorized representative or film artist.

(2) Books and documents specified under Rule 6F: The books of account and other documents prescribed under Rule 6F(2) are:

(i) a cash book;

In cases where the cash book maintained by the assessee contains adequate particulars in respect of the expenditure incurred by him, it would not be necessary to prepare and sign the payment voucher.

(ii) a journal, if the accounts are maintained under mercantile system of accounting

(iii) a ledger;

(iv) for an amount exceeding Rs.25, carbon copies of bills, whether machine numbered or otherwise serially numbered, wherever such bills are issued by the assessee and carbon copies or counterfoils of machine numbered or otherwise serially numbered receipts issued by him;

(v) original bills wherever issued to the assessee and receipts in respect of expenditure incurred by the assessee or, where such bills and receipts are not issued and the expenditure incurred does not exceed Rs.50, payment vouchers prepared and signed by the assessee.

(3) In addition to the above books of account and other documents, under Rules 6F(3) a person carrying on medical profession shall also maintain the following:

(i) a daily case register in Form No.3C;

(ii) an inventory under broad heads, as on the first and the last day of the previous year, of the stock of drugs, medicines and other consumable accessories used for the purpose of his profession.

(4) The books of account and other documents specified above under rule 6F(2) and 6F(3) shall be kept and maintained for a period of 6 years from the end of the relevant assessment year.

5.21 PRESUMPTIVE TAXATION FOR ASSESSEE ENGAGED IN BUSINESS OF PLYING, HIRING AND LEASING GOODS CARRIAGES

Section:- 44AE

(1) Eligible assessee:

Eligible assessee would mean an assessee engaged in business of plying, hiring and leasing goods carriages and not owning more than 10 goods carriages at any time during the previous year

(2) Presumptive Income

- The profits and gains from each goods carriage
 - (a) being heavy goods vehicle, shall be an amount equal to Rs.1,000 per ton of gross vehicle weight or unladen weight, as the case may be, for every month or part of a month during which the heavy goods vehicle is woned by the assessee in the previous year or an amount actually earned from such vehicle, whichever is higher;
 - (b) other than heavy goods vehicle, shall be an amount equal to Rs.7,500 for every month or part of a month during which the goods carriage is owned by the assessee in the previous year or an amount actually earned from the vehicle, whichever is higher
- The expressions “goods carriage”, “gross vehicle weight” and “unladen weight” shall have the respective meaning assigned to them in section 2 of the Motor Vehicles Act, 1988.
- The expression “heavy goods vehicle” means any goods carriage, the gross vehicle weight of which exceeds 12000 kilograms.

(3) Other salient features of this presumptive scheme

- All the deductions under section 30 to 38 shall deemed to have been allowed.
- If eligible assessee is a firm then it can claim deduction in respect of interest and salary paid to partners subject to the conditions and limits specified under section 40(b).
- The WDV of any asset shall be deemed to have been calculated as if the eligible assessee had claimed the deduction in respect of the depreciation for each of the relevant assessment years.
- An assessee opting for the above scheme shall be exempted from maintenance of books of accounts related to such business as required under section 44AA of the Income-tax Act.
- Where an eligible assessee declares lower profits than the profits required under this section, then he shall be required to keep and maintain books of accounts and other documents as per section 44AA and get them audited and furnish a report of such audit as required u/s 44AB.
- An assessee, who is in possession of a goods carriage, whether taken on hire purchase or on instalments and for which the whole or part of the amount payable is still due, shall be deemed to be the owner of such goods carriage.

Practical 22

M/s. Chhabada & Co., a partnership firm is engaged in the business of plying goods carriages. On **1st April, 2018**, it owns 10 goods carriages (9 goods carriages – gross vehicle weight of each being 30,000 kgs and one goods carriage heaving gross vehicle wiehgt of 12,000 kg.). On **2nd May, 2018**, firm sold one of the goods carriages (the gross vehicle weight was 12,000 kg.) and purchased another goods carriage (the gorss vehicle weight was 1,285 kg) on **6th May, 2018**. This new goods carraige could however be put to use only on **15th June, 2018**.

Compute the total income of M/s. Chhabada & Co. for the assessment year **2019-20**, taking note of the following data:

Particulars	Rs.
Freight charges collected	39,60,000
Less :	
Operational expenses	(6,25,000)
Depreciation as per section 32	(1,85,000)
Salary and interest to partners [as permitted by section 40(b)]	(20,00,000)
Other office expenses	(15,000)
Net profit	11,35,000
Income from other sources	70,000

Solution**Computation of Total income of Chhabada & Co. for the A.Y. 2019-20**

Particulars	Total Income, if books are not maintained	Total Income, if books are maintained and audited
Income from business of plying goods carriages	13,37,500 [Refer Notes]	11,35,000
Income from other sources	70,000	70,000
Total Income	14,07,500	12,05,000

Working Note: Calculation of presumptive income as per section 44AE

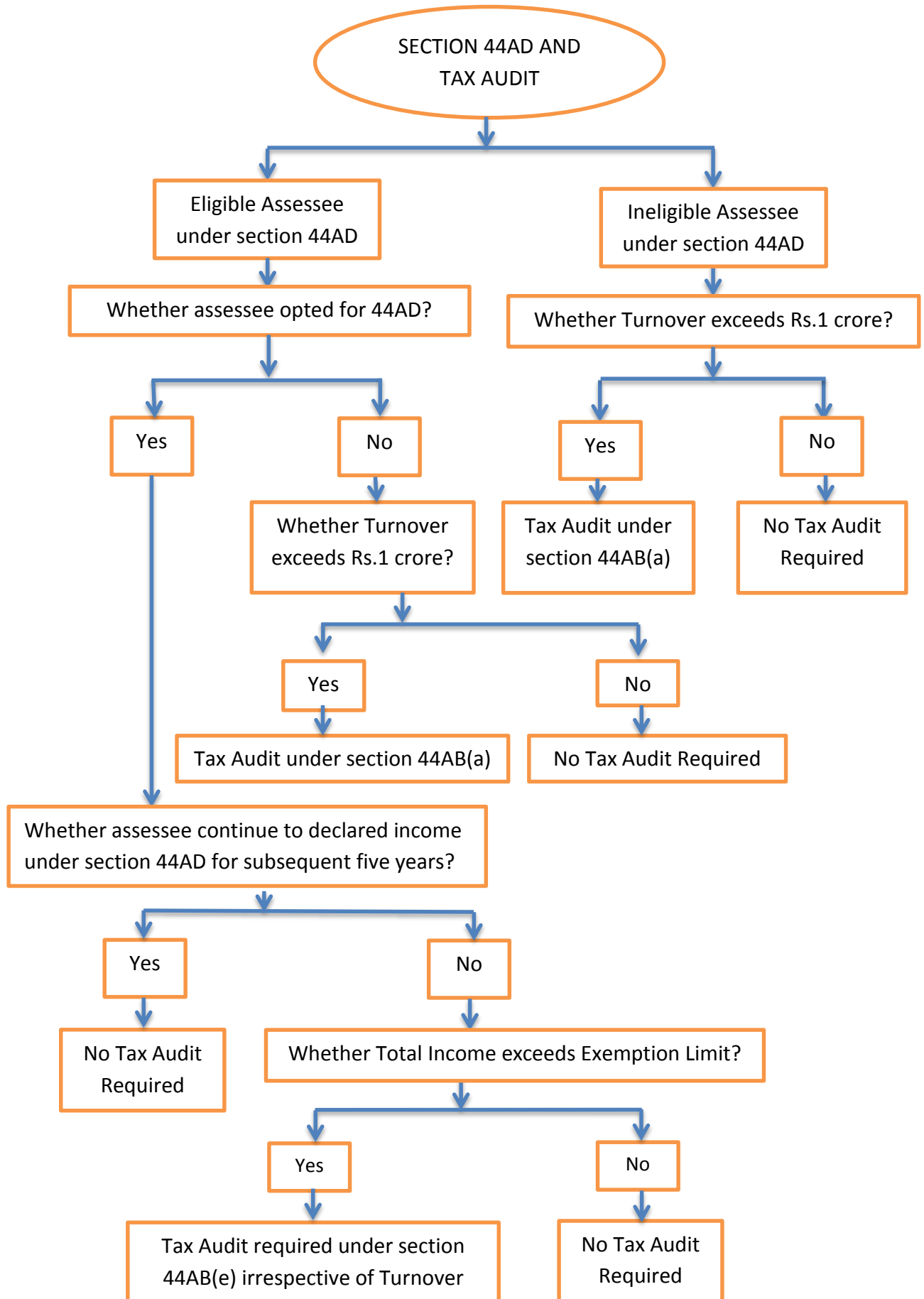
Particulars	No. of months	Rate per month	Amount (Rs.)
9 heavy goods vehicle – held throughout the year	12	30,000	32,40,000
1 other than heavy goods vehicle – held up to 2 nd May	2	7,500	15,000
1 other than heavy goods vehicle– held from 6th May	11	7,500	82,500
Presumptive Income as per section 44AE			33,37,500
Less: Salary and interest to partners (as permitted by section 40(b))			(20,00,000)
Net presumptive income under section 44AE			13,37,500

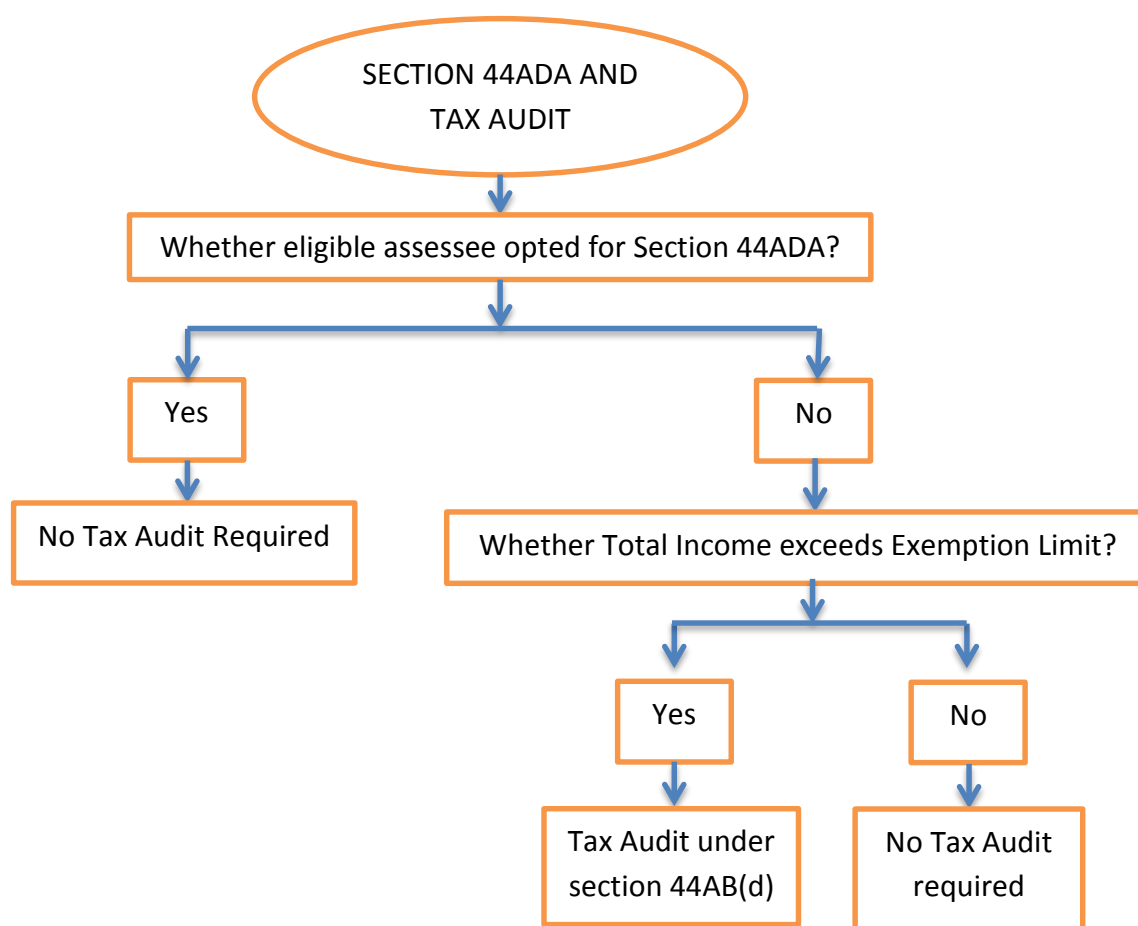
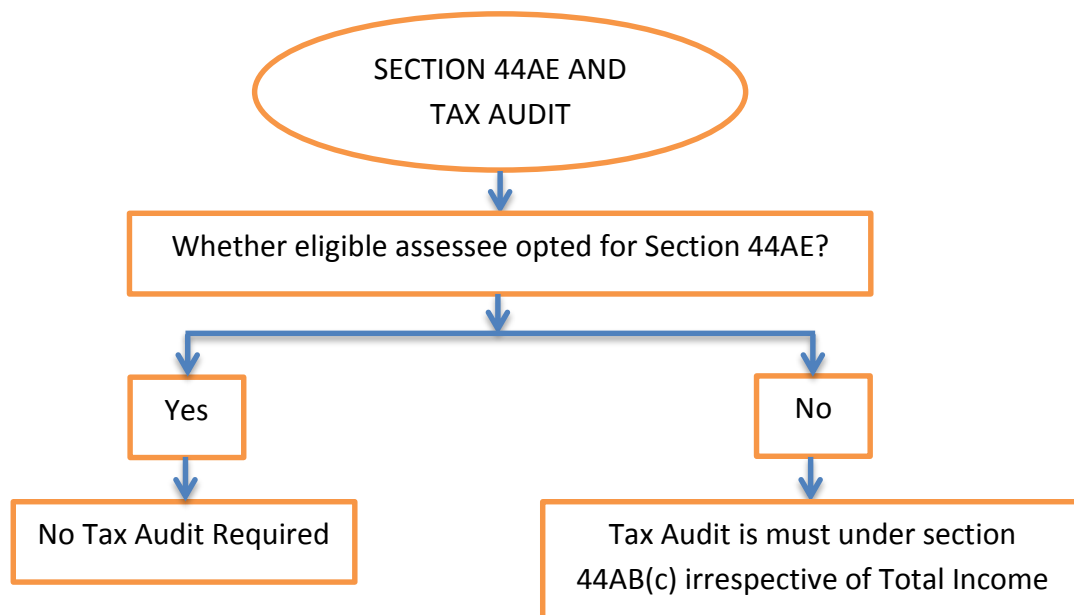
Other Notes:

1. M/s. Chhabada & Co., does not own more than 10 trucks at any time during the previous year Therefore, it is an eligible assessee under section 44AE of the Act.
2. Once firm opts for the section 44AE, all deductions under section 30 to 38 shall be deemed to have been allowed.
3. Further under section 44AE, firm is eligible to claim interest and remuneration paid to partners.

Reader's Note:

Presumptive taxation and tax audit, consider following:





Whether deduction of interest and remuneration to partner shall be allowed out of presumptive income?

Section 44AD	Section 44AE	Section 44ADA
No	Yes	No

5.22 TAXABILITY OF SPECULATIVE TRANSACTIONS**Section:- 43(5) and Explanation to Section 73****(1) Meaning**

Speculative transaction means a transaction involving a contract for purchase and sale of commodities, including stocks and shares, which is periodically or ultimately settled other than by actual delivery or transfer of commodities or scrips [Section 43(5)].

(2) Exceptions: [Proviso to Section 43(5)]

Following transactions are not regarded as speculative transactions

- (a) a contract in respect of raw materials or merchandise entered into by a person in the course of his manufacturing or merchandising business to guard against loss through future price fluctuations in respect of his contracts for actual delivery of goods manufactured by him or merchandise sold by him;
- (b) a contract in respect of stocks and shares entered into by a dealer or investor therein to guard against loss in his holdings of stocks and shares through price fluctuations;
- (c) a contract entered into by a member of a forward market or a stock exchange in the course of any transaction in the nature of jobbing or arbitrage to guard against loss which may arise in the ordinary course of his business as such member;
- (d) an eligible transaction in respect of trading in derivatives referred to in clause (ac) of section 2 of the Securities Contracts (Regulation) Act, 1956 carried out in a recognised stock exchange;
- (e) an eligible transaction in respect of trading in commodity derivatives carried out in a recognised association, which is chargeable to commodities transaction tax under Chapter VII of the Finance Act, 2013. ***However, in respect of trading in agricultural commodity derivatives, the requirement of chargeability of commodity transaction tax under Chapter VII of the Finance Act, 2013 shall not apply.***
[Amended by Finance Act, 2018 w.e.f. A.Y.2019-20]

(3) Speculative business in the case of a company [Explanation to sec. 73]

Where any part (or whole) of the business of a company consists in the purchase and sale of shares of other companies, such company shall be deemed to be carrying on a speculation business to the extent to which the business consists of the purchase and sale of such shares.

The above Explanation to section 73 does not apply to the following companies:

- (1) companies whose gross total income consists mainly of income which is chargeable under the heads 'Income from house property', 'Capital gains' and 'Income from other sources';
- (2) companies whose principle business is the business of banking;
- (3) companies whose principle business is the business of trading in share;
- (4) companies whose principle business is the business of granting loans and advances.

Practical 23

Surana Trading Pvt. Ltd. provides following information:

S.N.	Particulars	Rs.
(i)	Surplus from trading in goods (Delivery based)	4,80,000
(ii)	Surplus from trading in goods (Contracts settled without delivery)	3,22,000

(iii)	Loss from trading in commodity derivatives carried out on a recognized association, chargeable to CTT	1,22,000
(iv)	Loss from trading in agricultural commodity derivatives carried out on a recognized association, not chargeable to CTT	2,22,000
(v)	Surplus from trading in stock derivatives carried out on a recognized stock exchange	22,000

Find out income chargeable under the head “PGBP”.

5.23 DEDUCTION IN RESPECT OF EXPENDITURE ON ACQUISITION OF DISTRIBUTION RIGHTS OF FEATURE FILM (I.E. IN THE HANDS OF FILM DISTRIBUTOR)

Rule :- 9B

Where a feature film is acquired by the film distributor in any previous year and in such previous year,

(1) Situation (a)

The film distributor sells all rights of exhibition of the film, the entire cost of acquisition of the film shall be allowed as a deduction in computing the profits and gains of such previous year.

(2) Situation (b)

Where the film distributor

- (i) himself exhibits the film on a commercial basis in all or some of the areas; or
- (ii) sells the rights of exhibition of the film in respect of some of the areas; or
- (iii) himself exhibits the film on a commercial basis in certain areas and sells the rights of exhibition of the film in respect of all or some of the remaining areas,

and the film is released for exhibition on a commercial basis at least ninety days before the end of such previous year, the entire cost of production of the film shall be allowed as a deduction in computing the profits and gains of such previous year.

However, if film is not released for exhibition on a commercial basis at least ninety days before the end of such previous year, the cost of production of the film shall be allowed as deduction to the extent of amount realized from such release and the balance, if any, shall be carried forward to the next following previous year and allowed as a deduction in that year.

(3) Situation (c)

Where the film distributor does not himself exhibit the film on a commercial basis or does not sell the rights of exhibition of the film, no deduction shall be allowed in respect of the cost of production of the film in computing the profits and gains of such previous year; and the entire cost of production of the film shall be carried forward to the next following previous year and allowed as a deduction in that year.

(4) Meaning of Cost of acquisition

Cost of acquisition, in relation to a feature film, means the amount paid by the film distributor to the film producer or to another distributor under an agreement for acquiring the rights of exhibition and, where the rights of exhibition have been acquired on a minimum guarantee basis, the minimum amount guaranteed, but does not include—

- (i) the amount of expenditure incurred by the film distributor for the preparation of the positive prints of the film; and
- (ii) the expenditure incurred by him in connection with the advertisement of the film.

Practical 24

Meghna Film Distributors have acquired the rights of exhibition of a feature film 'Nasha' in the territory of Rajasthan from the producers under an agreement executed on **11.06.18** against a consideration of Rs. 300 lacs. It thereafter executed a sub-agreement with a distributor to whom the rights of exhibition of the film in some of the areas of Rajasthan were assigned against an amount of Rs. 100 lacs. The film was released for exhibition on commercial basis on **25.12.18**. Collection from the exhibition of film of "Meghna Film Distributors" for **25.12.2018 to 10.01.2019** was Rs. 50 lacs and thereafter up to **31.03.2019** was Rs. 190 lacs.

It asks you to clarify as to how these transactions will be reflected in the Income-tax return for **A.Y. 2019-20**. Would your answer be different if the film was released for exhibition on **11.01.2019**?

Solution

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

In the present problem, the agreement was executed on **11.06.2018** and the film also stands released for exhibition on commercial basis before 90 days from the end of the financial year i.e., on **25.12.18**. Accordingly, the profit of the assessee will be computed as under: -

Particulars	Rs. In lakhs
Collection from exhibition of film (Rs. 50 lakhs + Rs.190 lakhs)	240
Collection from sub-distributor	100
	340
Less : Cost of acquisition	
Amount paid to producer for exhibition rights of the film	(300)
Net income of film "Nasha"	40

Release of film for exhibition on commercial basis in the second case on **11.01.2019** i.e., less than 90 days before the end of the previous year. In this case, the profits of the assessee will be as under :-

Particulars	Rs. In lakhs
Collection from exhibition of film (Refer Note)	190
Collection from sub-distributor	100
	290
Less : Cost of acquisition	
Amount paid to producer for exhibition rights of the film (` 300 lacs, but restricted to Rs. 290 lacs)	(290)
Net income of film "Nasha"	Nil

The balance of Rs. 10 lacs (i.e. Rs. 300 lacs – Rs.290 las) has to be carried forward to the next following previous year and allowed as a deduction in that year i.e., **F.Y.2019-20**.

Note- Collection from exhibition of film from **25.12.2018 to 10.01.2019** amounting to Rs. 50 lacs is not considered in case of release of film on **11.01.2019** as it relates to a period before the date of release, so, it is relevant only in the first case when the film was released on **25.12.2019**.

Reader's Note:**5.24 GENERAL DEDUCTION****Section:- 37(1)**

Conditions for allowability of expenditure:

(1) The expenditure should not be in the nature as prescribed u/s. 30 to 36.

- (2) It should be incurred in connection with business or profession carried on by the assessee.
- (3) It should have been expended wholly and exclusively for the purpose of such business or profession.
- (4) The expenditure should not be in the nature of capital expenditure.
- (5) It should not be of personal expenditure.
- (6) It should be incurred during the previous year.

Explanation 1:- No deduction shall be allowed under this section in respect of an expenditure incurred for any purpose, which is an offence or is prohibited by law.

Explanation 2:- No deduction shall be allowed under this section in respect of an expenditure incurred by an assessee on the activities relating to corporate social responsibility referred to in section 135 of the Companies Act, 2013.

‡ **Circular No. 38/2016 dated 22.11.2016** ‡

Expenditure incurred on Keyman Insurance Policy

Issue:

Whether premium paid by the firm on the keyman Insurance policy of a partner, to safeguard the firm against disruption of the business, is an admissible expenditure under section 37 of the Act?

Clarification from CBDT

CBDT through this circular accepted the decision of the High Court of Punjab and Haryana in the case of M/s. Ramesh Steels, ITA No. 437 of 2015, vide judgement dated 02.02.2016 and clarified that in case of a firm, premium paid by the firm on the Keyman Insurance Policy of a partner, to safeguard the firm against a disruption of the business, is an admissible expenditure under section 37 of the Act.

(1) Summary of frequently tested issues on section 37(1)

Following are debited to profit and loss account. Discuss the allowability of the same while computing income under the head "PGBP" with reasons.

Sr. No.	Particulars of debit	Allowable / Disallow	Reason / Remark
1.	Compensation of Rs. 2,00,000 paid to the suppliers of automatic kitchen appliances because of termination of the contract after receipt of 50% of appliances	Disallow	Compensation paid for breach of a contract for supply of a capital asset is in the nature of capital expenditure as held by the Supreme Court in case of Swadeshi Cotton Mills Co. Ltd. vs. CIT (1967) 63 ITR 65.
2.	Wines and liquor imported and held as stock-in trade amounting to Rs. 5 lac. Entire stock so held were confiscated by the Custom Officer being an illegal import hence written off.	Allowable	The Apex Court in case of Dr. T.A. Quereshi vs CIT (2006) 287 ITR 547 observed that loss of stock-in-trade has to be considered as a trading loss. Business loss is allowable on ordinary commercial principles. Explanation to section 37(1) is not relevant here since it is not a case of business expenditure but one of business loss.

3.	Retrenchment compensation paid to employees of one of the units closed down during the year Rs.10,00,000.	Allowable	Compensation paid to workers on closing one of units be allowed to be deducted when there was unity of control and management of various units and all were assessed in assessee's hands as one business. - Jayshree Tea and Industries Ltd. v. CIT [2005] (Cal.); CIT V. JK Cotton Spinning & Weaving Co. Ltd. (2005) 145 Taxman 591 (All)
4.	Rs. 5 lacs paid to N. Ltd, towards feasibility study conducted for examining proposals for technological advancement relating to the existing business. The project was abandoned later.	Allowable	The Delhi High Court, in CIT v. Priya Village Roadshows Ltd. (2011) 332 ITR 594 , observed that in such cases, whether or not a new business/asset comes into existence would become the relevant factor. If there is no creation of a new asset, then the expenditure incurred would be of revenue nature.
5.	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. This project is not related to the existing business of the assessee.	Disallow	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 McGaw-Ravindra Laboratories (India) Ltd. v. CIT (1994) 210 ITR 1002 (Guj.)
6.	Commission of Rs. 1 lakhs paid to a recovery agent for realization of a debt. Tax has been deducted and remitted as per Chapter XVIIIB of the Act	Allowable	Commission paid to a recovery agent for realisation of a debt is an allowable expense under section 37(1) as per DCIT v. Super Tannery (India) Ltd. (2005) 274 ITR 338 (All)
7.	Rs. 12 lakhs paid towards course fee and hostel expenses for MBA course of a close relative of a director. The relative is not in employment with the company.	Disallow	Such expenditure is not incurred wholly and exclusively for the purposes of business and therefore not deductible under section 37 Enkay (India) Rubber Co. Pvt. Ltd v. CIT (2003) 263 ITR 521 (Del).
8.	Rs. 3 lakhs spent on gift items distributed to various dealers under the company's sales incentive scheme.	Allowable	Expenses on distribution of gift items to dealers under sales incentive scheme would promote goodwill and is made in the interest of business. Such gifts are prompted by commercial expediency and hence, the expenditure is allowable under section 37(1) [CIT v. Avery Cycle Industries Ltd. (2008) 298 ITR 239 / 296 ITR 393 (Punjab & Haryana)].
9.	Rs. 25 lacs paid for the higher studies of the director's son abroad, with a stipulation that he would be	Disallow	Since there is no evidence of existence of any "apprentice training scheme", the expenditure of Rs. 25 lakhs incurred in respect of higher

	appointed as a trainee in the company under "apprentice training scheme" where there is no evidence of existence of such scheme		studies abroad for the director's son is not allowable as deduction as there is no nexus between the education expenditure incurred abroad for the director's son and the business of the assessee. Bombay High Court in Echjay Forgings Ltd. v. ACIT (2010) 328 ITR 286.
10.	Secret commission of Rs. 3 lacs was paid.	Disallow	As per Explanation to section 37(1), 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. Therefore, payment of secret commission, if it is established as a payment for any purpose which is an offence or which is prohibited by law, cannot be allowed as deduction. Tarini Tarpauline Productions v. CIT (2002) 254 ITR 495 (Ori.)
11.	Purchased a brand new bus for Rs. 15 lacs and donated to a school where the employees' children were studying and debited the same to the Workmen and Staff Welfare Account.	Allowable	The expenditure incurred for acquiring a new bus and donating it to the school is for the welfare of the children of staff/workmen of the company. Such expenditure is a part of employees' welfare expenses incurred for the purpose of securing healthy services for staff members. Therefore, such expenses were incurred wholly and exclusively for the purpose of the business. Since the bus had been donated to the school, no benefit of enduring nature was derived by the assessee as the right of ownership was transferred to school. Hence, it is not a capital expenditure. Since such expenditure is incurred wholly and exclusively for the purpose of business and is not capital in nature, S Ltd. is entitled to claim deduction in full under section 37(1). Rajasthan High Court in CIT v. Rajasthan Spinning and Weaving Mills Ltd. (2006) 281 ITR 408.
12.	Legal fees incurred in defending title to factory premises	Allowable	Legal fees incurred in defending title to factory premises is an expenditure incurred wholly and exclusively for the purpose of business and is, therefore, allowable under section 37(1). Supreme Court in Dalmia Jain & Co. Ltd. v. CIT (1971) 81 ITR 754.

13.	Interest paid on arrears of GST	Allowable	Interest paid on arrears of sales tax is not penal in nature but is compensatory in character and is an allowable deduction under section 37(1) Supreme Court in Lachmandas Mathurdas v. CIT (2002) 254 ITR 799.
14.	Penalty for delay in filing of GST returns	Disallow	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.)
15.	Rs. 2,50,000 incurred on public issue of shares. However, the public issue could not materialize on account of non-clearance by SEBI	Disallow	Share issue expenses incurred by the company constitutes a capital expenditure, even though it could not go in for the public issue on account of non-clearance by SEBI. Though the efforts were aborted, the fact remains that the expenditure incurred was only for the purpose of expansion of the capital base. The capital nature of the expenditure would not be lost on account of the abortive efforts Mascon Technical Services Ltd. v. CIT (2013) 358 ITR 545 (Mad.)
16.	Rs. 1,00,000 paid as compounding fee for violation of provisions of Kerala Building Act.	Disallow	The amount paid for compounding an offence is inevitably a penalty and the mere fact that it has been described as compounding fee cannot, in any way, alter the character of the payment which is in the nature of penalty. Hence, the same is not allowable as revenue expenditure in view of explanation to section 37(1) Millenia Developers P Ltd. v. Deputy CIT (2010) 322 ITR 401 (Kar.).
17.	The company lost cash of Rs. 25,00,000 due to theft when it was withdrawn from bank and taken to administrative office.	Allowable	In order to determine whether any loss from theft, dacoity, embezzlement, etc., is deductible or not, what is material is whether the loss incurred by theft, dacoity, etc., is incidental to the carrying on of the business. It does not make much difference whether such act is committed by the employees of the assessee or by strangers G.G. Dandekar Machine Works Ltd. v. CIT (1993) 202 ITR 161 (Bom.)
18.	Rs.5 lakhs, being expenses incurred on the travelling of the wife of Managing Director, who accompanied him on tour to Beijing	Allowable	Expenses on travelling of wife of Managing Director to Beijing on the invitation of Trade and Commerce Chamber, China, is an allowable expense on the grounds of commercial expediency and business consideration. Hero

	on invitation of Trade & Commerce Chamber, China.		Honda Motors Ltd. v. CIT (2005) 3 SOT 572 (Delhi)
19.	Legal charges in connection with alteration of the Articles of Association Rs. 1.50 lacs	Allowable	Legal charges of for amendment of Articles of Association is deductible. Allahabad High Court in CIT vs Modi Spinning & Weaving Mills Co Ltd. (1973) 89 ITR 304.
20.	An executive, while on business trip abroad, died and gratuity paid voluntarily amounted to Rs. 6.00 lacs to his family members	Allowable	Payment of gratuity on account of death of an executive while on business trip is allowable as deduction. CIT vs. Laxmi Cement Distributors (P) Ltd. (1976) 104 ITR 711 (Gujarat)
21.	Rs. 2 lakh on alteration of Memorandum of Association in connection with increase in authorized capital.	Disallow	Rs. 2 lakhs, being legal expenses in relation to alteration of memorandum in connection with increase in Authorised Capital is directly related to expansion of the capital base of the company and is, hence, a capital expenditure. Therefore, the same is not allowable as deduction. It has been so held in Punjab State Industrial Development Corporation Ltd. vs. CIT (1997) 225 ITR 792 (SC).
22.	Rs. 10 lakh on issue of bonus shares	Allowable	There is no fresh inflow of funds or increase in capital employed on account of issue of bonus shares and there is only reallocation of the company's fund. Consequently, since there is no increase in the capital base of the company, legal expenses of Rs. 10 lakhs in connection with issue of bonus shares is a revenue expenditure and is hence, allowable as deduction. It has been so held by Apex Court in case of CIT vs. General Insurance Corpn. (2006) 286 ITR 232.
23.	Interest of Rs. 3,000 paid on an overdraft of Rs. 1 lac taken for making payment of installment of advance tax of Rs. 1.25 lacs.	Disallow	Interest on the overdraft taken for making payment of installment of advance tax is not allowable under section 37(1) since it is not an expenditure wholly and exclusively incurred for the purpose of business as held by the Apex Court in the case of East India Pharmaceutical Works Ltd. v. CIT (1997) 224 ITR 627.

Practical 25

XYZ Ltd. is engaged in the manufacture of textile since 01-04-2009. Its Statement of Profit & Loss shows a net 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, 2019 were remitted on 8th May 2019.

- (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 periodical 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 31-03-2019 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 31-03-2019, 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 XVIIIB 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 10-06-2018, 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 31-03-2018 towards repairing a machinery component. The tax so deducted was remitted on 31-12-2018.
- (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.

Solution**Computation of Total Income of XYZ Ltd. for the A.Y.2019-20**

Particulars	Rs.	Rs.
Net Profit as per Statement of Profit and Loss		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] [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].	2,00,000	

(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 [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]	Nil	
(e) Provision for wages payable to workers [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]	Nil	
(f) Provision for doubtful debts [10% of Rs. 200 lakhs] [Provision for doubtful debts is allowable as deduction under section 36(1)(vii) only in case of banks, public financial institutions, state financial corporations and state industrial investment 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 [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]	2,00,00,000	
(j) Commission paid to recovery agent for realization of a debt. [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]	Nil	
(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	10,00,000	

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.2017-18 was remitted only on 31.12.2018, i.e., after the due date of filing of return for A.Y.2018-19, 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 31.12.2018, Rs. 3,00,000 would be allowed as deduction while computing the business income of the A.Y.2019-20.

Reader's Note:

6 – CAPITAL GAINS

UNIT A – FUNDAMENTALS OF CAPITAL GAINS

6.1 TYPES OF CAPITAL ASSET

Section:- 2(42A)

As per section 2(42A), a **short-term capital asset** means capital asset held by an assessee for not more than 36 months immediately prior to its date of transfer.

However, in the following cases, an asset, held for not more than 12 months, is treated as short-term capital asset-

- (a) Equity or preference shares in a company (Listed in a recognized stock exchange)
- (b) Securities listed in a recognized stock exchange in India.
- (c) Units of UTI (whether listed or not)
- (d) Units of an equity oriented fund (whether listed or not)
- (e) Zero Coupon Bonds (whether listed or not)

Remark:

- In case of unlisted shares (equity or preference), if transfer takes place on or after 1st April, 2016, the period of holding not exceeding 24 months shall be taken into consideration instead of 36 months.*
- In case of an immovable property, being land or building or both, if transfer takes place on or after 1st April, 2017, the period of holding not exceeding 24 months shall be taken into consideration instead of 36 months.*

Practical 1

Mr. Jagmohan purchased residential building on 10th August, 2015. Thereafter, he sold out this building on 15th August, 2017. Determine the nature of asset.

Solution

Period of holding in respect of residential building exceeded 24 months. Hence, the residential building transferred by Mr. Jagmohan is a long term capital asset.

Reader's Note:

UNIT B – DEEMED FULL VALUE OF CONSIDERATION

6.2 SPECIAL PROVISIONS FOR COMPUTATION OF CAPITAL GAIN IN CASE OF JOINT DEVELOPMENT AGREEMENT

Section:- 45(5A) and 49(7) - Effective from A.Y.2018-19

Section 45(5A):- Taxability of capital gains in case of Specified agreement:

The definition of 'transfer', inter alia, includes any arrangement or transaction where any rights are handed over in execution of part performance of contract, even though the legal title has not been transferred.

And therefore, execution of Joint Development Agreement between the owner of immovable property and the developer attracts capital gain tax liability in the hands of owner in the year in which possession is handed over to the developer.

With a view to minimize the genuine hardship which the owner of land or building may face in paying capital gains tax in the year of transfer, a sub-section (5A) in section 45 has been inserted to provide that

- in case of an assessee being **individual or Hindu undivided family who transfers land or building or both under a specified agreement,**
- **then capital gain arising from such transfer shall be chargeable to income-tax as income of the previous year in which the certificate of completion for the whole or part of the project is issued by the competent authority.**

What is the full value of consideration? The stamp duty value of his share, being land or building or both, in the project on the date of issuing of said certificate of completion as increased by any consideration received in cash, if any, shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of the capital asset.

Benefit of provisions of section 45(5A) not available [Proviso to section 45(5A)]:- It may, however, be noted these beneficial provisions would not apply, where the assessee transfers his share in the project on or before the date of issue of said completion certificate and therefore, the capital gain tax liability would be deemed to arise in the previous year in which such transfer took place. In such a case, full value of consideration received or accruing shall be determined by the general provisions of the Act.

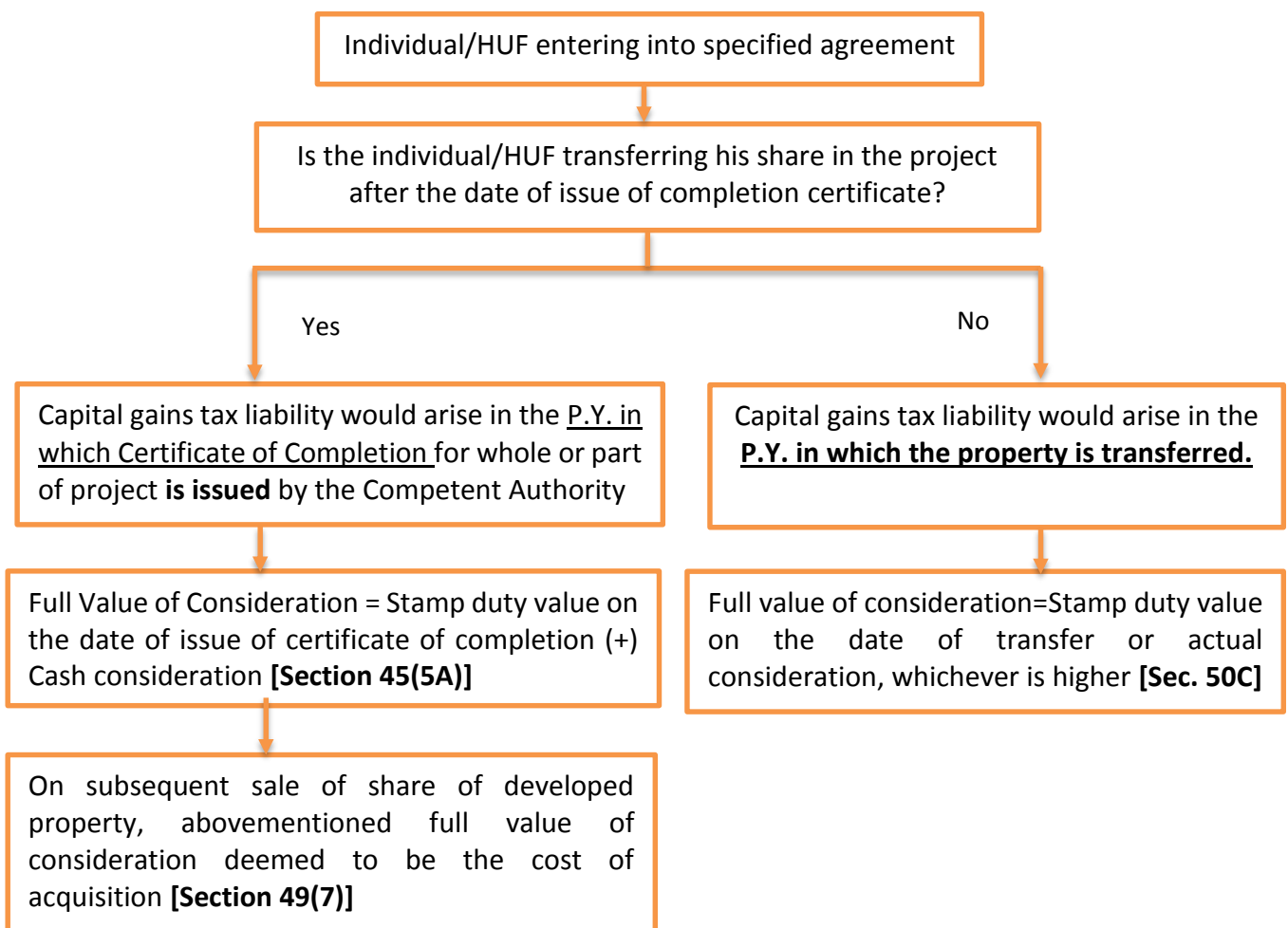
Meaning of certain terms:

- (a) **Specified Agreement:-** Specified agreement means the registered agreement in which a person owning land or building or both, agrees to allow another person to develop a real estate project on such land or building or both, in consideration of a share, being land or building or both in such project, whether with or without payment of part of the consideration in cash.
- (b) **Competent authority:-** The authority empowered to approve the building plan by or under any law for the time being in force.
- (c) **Stamp duty value:-** The value adopted or assessed or reassessable by any authority of Government for the purpose of payment of stamp duty in respect of an immovable property being land or building or both.

Section 49(7):- Cost of acquisition of capital asset, being share in the project referred u/s 45(5A)

Where the capital gain arises from the transfer of a capital asset, being share in the project, in the form of land or building or both, referred to in section 45(5A) which is chargeable to tax in the previous year in which the completion of certificate for the whole or part of the project is issued by the competent authority), the cost of acquisition of such asset, shall be the amount which is deemed as full value of consideration in that sub-section.

SUMMARY



Practical 2

Mr. Abhinav provides following information:

- He purchased small plot of land in Ahmedabad on 10th July 1998 for Rs. 10 lakh (fair market value of such plot as on 1st April, 2001 was Rs. 12 lakh)
- He entered into a "Specified Agreement" with Amrapali Developers Ltd. on **18th May 2018**.
- Agreed consideration was : Cash component Rs. 1 Crore and 50% share in constructed area
- Project completion certificate was issued by Local authority on **10th August, 2019**.
- Stamp duty valuation of 50% share in constructed area (as on **10th August, 2019**): Rs. 2.25 Crore.
- He sold out the constructed area allotted to him on **1st May, 2020** for Rs. 3 Cr.

Discuss tax consequences of above transaction in the hands of Mr. Abhinav.

Solution**Computation of Capital Gain in the hands of Abhinav for P.Y. 2019-20**

Period of Holding: 10-07-1998 to 18-05-2018	
Nature of Capital Asset: Long Term	
Particulars	Rs.
Full value of consideration (Rs. 1 Cr. + Rs. 2.25 Cr.)	3,25,00,000
Less: Expenses in connection with Transfer	Nil
Net Considerations	3,25,00,000
Less: Indexed Cost of Acquisition (Rs. 12,00,000)	(33,60,000)
	$\times \frac{280}{100}$
Taxable Long-Term Capital Gain	2,91,40,000

Computation of Capital Gain in the hands of Abhinav P.Y. 2020-21

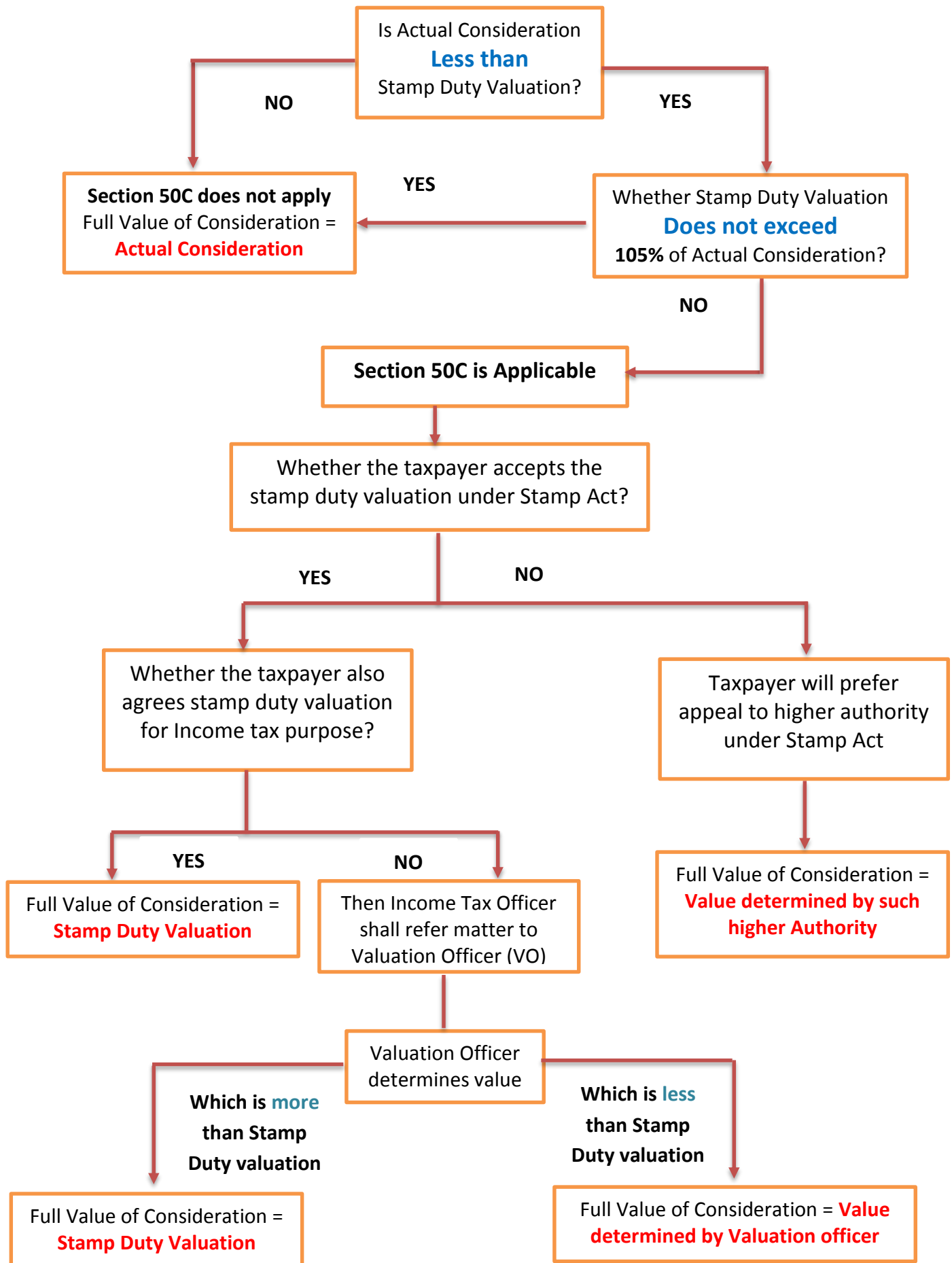
Period of Holding: 10-08-2019 to 01-05-2020	
Nature of Capital Asset: Short Term	
Particulars	Rs.
Full value of consideration	3,00,00,000
Less: Expenses in connection with Transfer	Nil
Net Consideration	3,00,00,000
Less: Cost of Acquisition as per section 49(7)	(2,25,00,000)
Taxable Short Term Capital Gain	75,00,000

Reader's Note:

6.3 FULL VALUE OF CONSIDERATION IN CASE OF REAL ESTATE TRANSACTIONS

Section:- 50C

This section is applicable when consideration received on transfer of land or building or both is less than the value adopted by Stamp Authority for the purpose of payment of stamp duty. Consider the following chart:-



NOTES RELEVANT FOR SECTION 50C:

(1) Following third proviso shall be inserted in sub-section (1) of section 50C by the Finance Act, 2018, w.e.f. 1-4-2019.

Provided that where the value adopted or assessed or assessable by the authority for the purpose of payment of stamp duty does not exceed one hundred and five per cent of the consideration received or accruing as a result of the transfer, the consideration so received or accruing as a result of the transfer shall, for the purposes of section 48, be deemed to be the full value of the consideration.

Readers must note that the effect of this proviso has already been incorporated in the chart discussed above.

(2) As per first and second proviso to section 50 C(1) as inserted by Finance Act, 2016, if there is a time gap between the date of the agreement and the date of registration, the stamp duty value may be taken as on the date of agreement instead of the date of registration.

However, for the same, at least a part of the consideration has been received by way of an account payee cheque or account payee bank draft or by use of electronic clearing system through a bank account, on or before the date of the agreement.

Practical 3

Bala sold his vacant site on **30.09.2018** for Rs. 7,00,000 . It was acquired by him on 01.10.2004 for Rs. 1,50,000. The state stamp valuation authority fixed the value of the site at the time of transfer @ Rs. 13,00,000. Compute capital gains in the hands of Bala and give your reasons for computation.

What would have been the capital gain if Bala sold this vacant site for Rs. 12,50,000?

Solution

(a) **Computation of Capital Gain if Bala sold vacant site for Rs.7,00,000**

Period of Holding : 01.10.2004 to 30.09.2018	
Nature of Capital Asset: Long Term	
Particulars	(Rs.)
Full value of consideration under section 50 C	13,00,000
Less: Expenses in connection with Transfer	-
Net Consideration	13,00,000
Less: Indexed Cost of acquisition $1,50,000 \times \frac{280}{113}$	(3,71,681)
Long Term Capital Gain	9,28,319

(b) **Computation of capital gain if Bala sold vacant site for Rs. 12,50,000.**

As per third proviso to section 50C(1), if stamp duty valuation (in this case Rs. 13,00,000) does not exceed 105% of the consideration (Rs. 12,50,000) [which comes to Rs.13,12,500], then actual consideration i.e. Rs. 12,50,000 shall be deemed to be the full value of consideration.

Period of Holding : 01.10.2004 to 30.09.2018	
Nature of Capital Asset: Long Term	
Particulars	(Rs.)
Full value of consideration under section 50 C	12,50,000
Less: Expenses in connection with Transfer	-
Net Consideration	12,50,000
Less: Indexed Cost of acquisition $1,50,000 \times \frac{280}{113}$	(3,71,681)
Long Term Capital Gain	8,78,319

Readers Note:

6.4 FAIR MARKET VALUE TO BE THE FULL VALUE OF CONSIDERATION FOR TRANSFER OF UNQUOTED SHARES - Effective from A.Y.2018-19

Section:- 50CA

In order to ensure the full consideration is not understated in case of transfer of unlisted shares, a new section 50CA has been inserted to provide that where the consideration received or accruing as a result of transfer of a capital asset, being share of a company other than a quoted share, is less than the fair market value of such share determined in such manner as may be prescribed, such fair market value shall be deemed to be the full value of consideration received or accruing as a result of such transfer.

For the purpose, “quoted shares” means the share quoted on any recognized stock exchange with regularity from time to time, where the quotation of such share is based on current transaction made in the ordinary course of business.

Note:

The fair market value of the unquoted shares would be determined in the manner provided in sub-clause (b) or sub-clause (c), as the case may be, of Rule 11UA(1)(c) and for this purpose the reference to valuation date in the Rule 11U and 11UA shall mean the date on which the capital asset, being unquoted share of a company is transferred (Rule 11UAA).

For determination of fair market value: Refer Rule 11U and Rule 11UA under **Chapter 7: Income from Other Sources**.

Practical 4

Mr. Dravid provides following information:

- He subscribed shares of ABC Infrastructure Private Limited for Rs. 12,00,000 on 16th May, 2001.
- He sold out these shares for Rs. 85,00,000 on 18th May, 2018.
- Fair market value of this share on 18th May, 2018 was Rs. 98,00,000.

Discuss tax consequences of above transaction in the hands of Mr. Dravid.

Solution

Computation of Long Term Capital Gain in the hands of Mr. Dravid for P.Y.2018-19

Period of Holding: From 16-05-2001 to 18-05-2018	
Type of Capital Asset : Long Term	
Particulars	Rs.
Full value of consideration (actual consideration or FMV whichever is higher)	98,00,000
Less: Expenses in connection with Transfer	Nil
Net Consideration	98,00,000
Less: Indexed Cost of Acquisition	$(Rs. 12,00,000) \times \frac{280}{100}$
	33,60,000
Taxable Long Term Capital Gain	64,40,000

Reader's Note:

UNIT C – DEEMED COST OF ACQUISITION

6.5 HOW TO FIND OUT CAPITAL GAINS WHEN EQUITY SHARES RECEIVED ON CONVERSION ARE SUBSEQUENTLY SOLD?

Section:- 49(2AE) - Effective from A.Y.2018-19

- Section 49(2AE) has been inserted to provide that cost of acquisition of preference shares shall be treated as cost of acquisition for equity shares (received on conversion).

- (b) Further, to find out whether such equity shares received on conversion are long-term capital assets or not, the period of holding shall be determined from date of acquisition of preference shares of such company.–

Explanation 1 to section 2(42A).

- (c) The benefit of indexation will start from the date of acquisition of preference shares in the company.

Practical 5

Ms. Mayuri subscribed 10,000 preference shares of Online Education Private Limited @ Rs. 10 each on 18th August, **2016**. Such shares were converted into 12,500 equity shares on 10th April, **2018**. She then transferred 8,000 shares on 21st September, **2018** for Rs. 12 per share. Discuss tax consequences of above transaction in the hands of Ms. Mayuri.

Solution

As discussed earlier, conversion of preference shares into equity shares is not treated as transfer by virtue of section 47 (xb). Therefore, conversion will not attract capital gain tax liability in the hands of Ms. Mayuri.

Computation of Capital Gain in the hands of Ms. Mayuri.

Period of Holding: From 18-08- 2016 to 21-09- 2018	
Type of Capital Asset : Long Term	
Particulars	Rs.
Full value of consideration (8,000 X Rs. 12)	96,000
Less: Expenses in connection with Transfer	Nil
Net Consideration	96,000
Less: Indexed Cost of Acquisition (Working Note)	(67,879)
Taxable Long Term Capital Gain	28,121

Working Note:-

Total Cost of 12500 equity shares	= Cost of preference shares = 10000 × Rs. 10 = Rs.1,00,000
Hence, cost per equity share	= $\frac{1,00,000}{12500}$ = Rs.8
Hence, cost of acquisition of 8000 equity shares	= 8000 × Rs.8 = Rs.64,000
Therefore, Indexed Cost of Acquisition =	= $\left(64000 \times \frac{280}{264}\right)$ = Rs.67,879

Readers Note:

6.6 COST OF ACQUISITION IN THE CASE OF CONVERSION OF STOCK-IN-TRADE INTO CAPITAL ASSET

Section:- 49(9) - Inserted by Finance Act, 2018 w.e.f. A.Y. 2019-20.

If stock in trade is converted in to capital asset, cost of such capital asset shall be declared to be the fair market value which has been taken into account for the purpose of section 28(via) [i.e., fair market value on the date of conversion of stock-in-trade into capital asset].

Practical 6

Mr. Rajesh Shah is a proprietor of “Abhushan Jewelers”. He closed down this shop w.e.f. 10th July, **2018** and converted stock-in-trade into capital asset with immediate effect. On such date, the book value of jewelry was Rs. 30,00,000 while fair market value of such jewelry was Rs. 30,62,000. Later on, he sold out such jewelry on 10th March, 2020 for Rs. 31,12,000. Discuss tax consequences in the hands of Mr. Rajesh assuming that such jewelry was purchased on 2nd April, 2018.

Solution**Computation of Business Income for A.Y. 2019-20**

Particulars	Rs.
Sale consideration=Fair Market Value on the date of conversion [Section 28(via)]	30,62,000
Less: Purchase Cost	(30,00,000)
Taxable Business Income	62,000

Computation of Capital Gain in the hands of Mr. Rajesh for A.Y.2020-21

Period of Holding: 02.04.2018 to 10.03.2020	
Type of Capital Asset : Short Term	
Particulars	Rs.
Full value of consideration	31,12,000
Less: Expenses in connection with Transfer	Nil
Net Consideration	31,12,000
Less: Cost of Acquisition [Fair Market value adopted for the purpose of section 28(via)]	(30,62,000)
Short Term Capital Gain	50,000

Readers Note:

UNIT D – EXEMPTION UNDER SECTION 10**6.7 EXEMPTIONS UNDER SECTION 10****Section:- 10(33) and 10(37)**

Sec.	Eligible Assessee	Nature Of Income	Conditions/Definitions/Comments
10(33)	Any assessee	Capital Gain from transfer of units of Unit Scheme 1964.	The transfer of such unit is made after 1-4-2002
10(37)	Individual / HUF	Capital Gains arising out of sale of agricultural land	(1) The land is situated in area as referred to in section 2(14)(iiia) or 2(14)(iiib) (2) Such land was used in previous two years from the date of transfer for agricultural purpose by the assessee or his parents (3) Transfer is by way of compulsory acquisition or consideration or enhanced consideration of which is approved by RBI or Central Government (4) such income arises on or after 1.4.2004

6.8 TAX INCENTIVE FOR THE DEVELOPMENT OF CAPITAL OF ANDHRA PRADESH**Section:-** 10(37A), 49 (6) and 194LA

Section 10(37A) :- Exemption in respect of capital gains arising on transfer of Specified Capital Assets under the Land Pooling Scheme notified under the provisions of Andhra Pradesh Capital Region Development Authority Act, 2014. [With retrospective effect from A.Y.2015-16]

As per section 96 of the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2014, the specified compensation received by the landowner in lieu of acquisition of land is exempt from income tax. The Land Pooling Scheme is an alternative form of arrangement made by the Government of Andhra Pradesh for formation of new capital city of Amaravati to avoid land acquisition disputes and lessen the financial burden associated with payment of compensation under that Act.

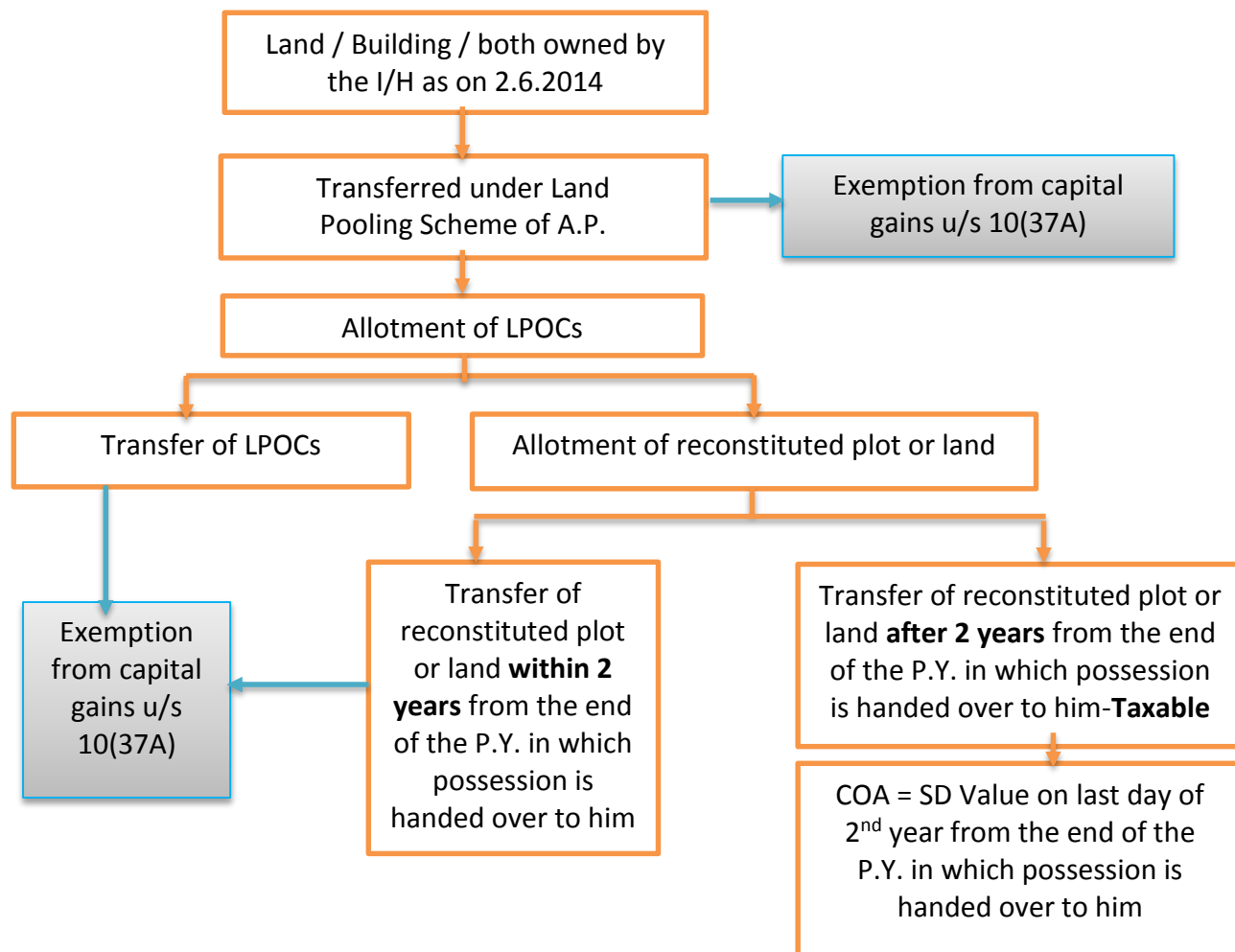
- In Land pooling scheme, the compensation in the form of reconstituted plot or land is provided to land owners. However, the existing provisions of the Act do not provide for exemption from tax on transfer of land under the land pooling scheme as well as on transfer of Land Pooling Ownership Certificates (LPOCs) or reconstituted plot or land.
- With a view to provide relief to an individual or Hindu undivided family who was the owner of such land as on 2nd June, 2014, and has transferred their land or building or both, under the land pooling scheme notified under the provisions of Andhra Pradesh Capital Region Development Authority Act, 2014, clause (37A) has been inserted in section 10 to provide that in respect of said persons, capital gains arising from the transfer of the followings, specified capital assets, shall not be chargeable to tax under the Act:
 - Transfer of capital asset being land or building or both, under land pooling scheme.
 - Sale of LPOCs by the said persons received in lieu of land transferred under the scheme.
 - Sale of reconstituted plot or land by said persons within two years from the end of the financial year in which the possession of such plot or land was handed over to the said persons.

Section 49(6):- Cost of Acquisition of reconstituted plot or land: [With Effect from A.Y.2018-19]

Where the capital gain arises from the transfer of a reconstituted plot or land, (received by the assessee in lieu of land or building or both transferred under the Land Pooling Scheme of Andhra Pradesh) which has been transferred after the expiry of 2 years from the end of the financial year in which the possession of such plot or land was handed over to the assessee, the cost of acquisition of such reconstituted plot or land shall be deemed to be its stamp duty value as on the last day of the second financial year after the end of the financial year in which the possession of the said plot or land was handed over to the assessee.

For this purpose, “stamp duty value” means the value adopted or assessed or reassessable by the authority of the State Government for the purpose of payment of stamp duty in respect of an immovable property.

Section 194LA :- No Tax deduction shall be made in respect of any award or agreement which has been exempted from income-tax under section 96 of the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013. **(Effective from 1st April, 2017)**

**Practical 7**

Mr. Aadinath provides following information:

- (a) He purchased plot of land for Rs. 10,000 on 3rd January, 1998 in Amarawati.
- (b) This plot of land was transferred under land pooling scheme on 10th July, 2014.
- (c) As a result, Land Pooling Ownership Certificate (LPOC) was issued to him.
- (d) He then transferred this LPOC for Rs. 12,00,000 on 15th September, 2015.

Discuss tax consequences of the above transaction in the hands of Mr. Aadinath.

Solution**Previous year 2014-15**

As per the provisions of Section 10(37A) of the Act, any capital gain arising to Individual / HUF on transfer of land under Land Pooling Scheme is exempt. Therefore, transfer of land by Mr. Aadinath under land pooling scheme will not result into any tax liability.

Previous year 2015-16

As per the provisions of Section 10(37A) of the Act, any capital gain arising to Individual / HUF on transfer of LPOC is also exempt. Therefore, transfer of such LPOC by Mr. Aadinath will not result into any tax liability.

Reader's Note:**Practical 8**

Continuing above problem, assuming that Mr. Aadinath had not transferred LPOC. The Andhra Pradesh Government allotted him a reconstituted plot of land on 15th March, 2016, however, the possession of reconstituted plot was handed over to him on 2nd April, 2016. Discuss Tax consequences in the hands of Mr. Aadinath under following alternatives

(a) Mr. Aadinath has transferred reconstituted plot on 10th March, 2019 for Rs. 20,21,000

(b) Mr. Aadinath has transferred reconstituted plot on 15th April, 2019 for Rs. 21,51,000

Note: Stamp duty valuation of such reconstituted plot on 31st March, 2019 was Rs. 20,25,000

Solution

Alternative (a)

Previous year 2018-19

As per the provisions of Section 10(37A) of the Act, any capital gain arising to Individual / HUF on transfer of reconstituted plot is exempt provided such reconstituted plot has been transferred within 2 years from the end of financial year in which the possession of such plot was handed over to him.

Therefore, under this alternative, Mr. Aadinath is not required to pay any capital gain tax liability on transfer of such reconstituted plot.

Alternative (b)

Previous year 2019-20

Since transfer of reconstituted plot has been made after the end of 2 years from the end of financial year in which possession of reconstituted plot was handed over to Mr. Aadinath, he is liable to pay tax on capital gain arising on such transfer.

For the purpose of computing capital gain, following points merit consideration:

- (i) Period of Holding: 2nd April, 2016 to 15th April, 2019
- (ii) Full value of Consideration: Rs. 21,51,000
- (iii) Cost of acquisition as per the provision of section 49(6) of the Act : Rs. 20,25,000

Reader's Note:

6.9 | EXEMPTION FROM LONG TERM CAPITAL GAINS SCHME MODIFIED

Section:- 10(38)

With effect from A.Y.2019-20, as amended by Finance Act, 2018, nothing contained in this clause shall apply to any income arising from the transfer of long-term capital asset, being an equity share in a company or a unit of an equity oriented fund or a unit of a business trust, made on or after the 1st day of April, 2018.

UNIT E – EXEMPTION UNDER SECTION 54 TO 54GB

6.10 | EXEMPTIONS FROM CAPITAL GAIN

Section:- 54EC

Q 1. Who can claim exemption?

Ans. Any person

Q2. What is the nature of capital asset which has been transferred?

Ans. Long Term Capital Asset

Q3. Which specific asset is eligible for exemption (that means which asset has been transferred?)

Ans. Long Term Capital Asset **being land or building or both [Amended by Finance Act, 2018 w.e.f A.Y.2019-20].**

Q4. Which asset the tax-payer shall acquire to avail exemption under this section?

Ans. Bonds of National High-way Authority of India (NHAI) or Rural Electrification Corporation Limited or **any other notified by the Central Government in this behalf.**

Notification No. 47/2017 dated 8th June, 2017:- Bonds (redeemable after three years) issued on or after 15th day of June, 2017 by Power Finance Corporation Limited are eligible for availing benefit u/s 54EC.

Notification No. 79/2017 dated 8th August, 2017:- Bonds (redeemable after three years) issued on or after 8th day of August, 2017 by Indian Railway Finance Corporation Limited are eligible for availing benefit u/s 54EC

Q5. What is time-limit for acquiring the new capital asset?

Ans. Six months from the date of transfer

Q6. What is the quantum of exemption?

Ans. Exemption under section 54EC = Amount invested in new asset or capital gain whichever is lower

Upper Limit for exemption: Under no circumstances, exemption under 54EC shall exceed Rs. 50 Lac in a financial year.

Q7. Is it possible to revoke the exemption in a subsequent year? (Can exemption be taken back?)

Ans. Yes.

If investment is made on or after 1 st April 2018	If new asset is transferred or converted into money or loan is taken on the security of new asset within 5 years from the date of its acquisition [Amended by Finance Act, 2018 w.e.f A.Y. 2019-20]
If investment is made before 1 st April 2018	If new asset is transferred or converted into money or loan is taken on the security of new asset within 3 years from the date of its acquisition

Q7.1. What is the nature of capital gain if exemption is taken back in subsequent year?

Ans. Long term

Q8. Is scheme of deposit available?

Ans. No

Practical 9

Mrs. X, resident woman, transfers (Date of transfer:-January 16, **2019**) a house property resulting into long term capital gain of Rs. 1,01,50,000. She invests a sum of Rs. 45,00,000 in capital gains bonds issued by Power Finance Corporation Limited on March 5, **2019**. She further invests a sum of Rs. 46,00,000 in the same bonds on May 5, **2019**. Accordingly, she wants to claim exemption of Rs. 91,00,000 under 54EC. Advise her suitably.

What would have been the amount of exemption under section 54 EC if Mrs. X transferred gold ornaments instead of house property?

6.11 EXEMPTIONS FROM CAPITAL GAIN

Section:- 54G

Q 1. Who can claim exemption?

Ans. Any person

Q2. What is the nature of capital asset which has been transferred?

Ans. Short Term / Long Term Capital Asset

Q3. Which specific asset is eligible for exemption (that means which asset has been transferred?)

Ans. Land, building, plant or machinery in order to shift an industrial undertaking from urban area to rural area.

Q4. Which asset the tax-payer shall acquire to avail exemption under this section?

Ans. Land, building, plant or machinery for the purpose of the business of industrial undertaking in rural area.

Q5. What is time-limit for acquiring the new capital asset?

Ans. For purchase: 1 year backward or 3 years forward from date of transfer

Q6. What is the quantum of exemption?

Ans. Readers are advised to follow below mentioned chart strictly

Particulars	Amount Rs.
Compute Capital gain on sale of Land	
Compute Capital gain on sale of Building	
Compute Capital gain on sale of P & M	
Aggregate all of above (A)	
Less: Exemption under section 54G (Refer working note) (B)	
Remark: Exemption shall not exceed (A)	
Balance Taxable Capital Gain (C) = (A-B)	
Compute Capital gain on sale of other asset, if any (D)	
Total Capital Gain Chargeable to Tax = (C) plus (D)	

Working Note: Exemption under section 54G is aggregate of the followings:

Particulars	Amount Rs.
Amount invested in Land at Rural Area	
Amount invested in Building at Rural Area	
Amount invested in Plant & Machinery at Rural Area	
Amount of Shifting Expenditure incurred (don't forget this)	
Total	

Q7. Is it possible to revoke the exemption in a subsequent year? (Can exemption be taken back?)

Ans. Yes. If new asset is transferred within 3 years from the date of its acquisition.

Q7.1. What is the nature of capital gain if exemption is taken back in subsequent year?

Ans. Short term

Q8. Is scheme of Deposit available?

Ans. If the new asset is not acquired on or before the due date of filing return under section 139(1), then the taxpayer will have to deposit the money in "Capital gain deposit account scheme" with a nationalized bank. Exemption under this section shall be worked out on the basis of actual investment and the amount deposited in the abovementioned scheme.

The taxpayer is required to acquire a new asset by withdrawing from the deposit account. But the new asset must be acquired within the dead-line mentioned in **Q5** above.

If a deposit account is not fully utilized for acquiring the new asset, the unutilized amount will become chargeable to tax in the previous year in which the 3 years' time – limit from date of transfer expires.

The unutilized amount can be withdrawn by the taxpayer only after the expiry of 3 years' time-limit from the date of transfer.

Practical 10

X Ltd, located within the corporation limits, decided in December, **2018** to shift its industrial undertaking to non-/urban area. The company sold some of the assets and acquired new assets in the process of shifting. Further, it incurred Rs. 25,000 as shifting expenses. The relevant details are as follows:

(Rs. In lakhs)

Particulars	Land	Building	Plant & Machinery	Furniture
Sale proceeds (sale effected in March, 2019)	8	18	16	3
Indexed cost of acquisition	4	10	12	2
Cost of acquisition in terms of section 50	-	4	5	2
Cost of new assets purchased in July, 2019 for the purpose of business in the new place	4	7	17	2

Compute the capital gains of X Ltd. for the previous year **2018-19**.

Solution**Computation of Capital Gain for the Previous Year 2018-19 in the hands of X Ltd.**

Particulars	Amount (Rs.)
Long Term Capital gain on sale of Land (Rs.8,00,000 less Rs. 4,00,000)	4,00,000
Short Term Capital gain on sale of Building (Rs. 18,00,000 less Rs. 4,00,000)	14,00,000
Short Term Capital gain on sale of P & M (Rs.16,00,000 less Rs. 5,00,000)	11,00,000
Aggregate all of above (A)	29,00,000
Less: Exemption under section 54G (Refer working note) (B)	28,25,000
Remark: Exemption shall not exceed (A)	
Balance Taxable Capital Gain (C)= (A-B)	75,000
Short Term Capital gain on sale of Furniture (Rs. 3,00,000 less Rs.2,00,000) (D)	1,00,000
Total Capital Gain Chargeable to Tax = (C) plus (D)	1,75,000

Working Note: Exemption under section 54G is aggregate of the followings:

Particulars	Amount (Rs.)
Amount invested in Land at Rural Area	4,00,000
Amount invested in Building at Rural Area	7,00,000
Amount invested in Plant & Machinery at Rural Area	17,00,000
Amount of Shifting Expenditure incurred (don't forget this)	25,000
Total	28,25,000

Readers Note:

7 – INCOME FROM OTHER SOURCES

7.1 MEANING OF DIVIDEND

Sections:- 56(2)(i) and 2(22)(a) to 2(22)(e)

Section 2(22) of the Income Tax Act defines term “dividend”. This definition is inclusive one. It covers five sub clauses (a) to (e). Let us understand each clause one by one.

(1) Distribution of accumulated profits entailing (requiring / necessitating) release of company’s assets [Section 2(22)(a)]

In order to be called dividend under this clause, following two conditions are required to be satisfied.

- First** Distribution by a company out of accumulated profits (whether capitalized or not) and
- Second** Such distribution entails release of the assets by the company to its shareholders.

(2) Distribution of accumulated profits in the form of debentures, preference bonus shares etc. [Section 2(22)(b)]

This clause covers following two distributions to be treated as deemed dividend to the extent of accumulated profits (whether capitalized or not)-

- a.** Distribution by a company to its shareholders of
 - debentures,
 - debenture-stock or
 - deposit certificates
 - in any form, whether with or without interest; and
- b.** Distribution by a company to its preference shareholders of preference bonus shares.

(3) Distribution of accumulated profits at the time of liquidation [Section 2(22)(c)]

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

(4) Distribution of accumulated profits on the reduction of capital [Section 2(22)(d)]

Any distribution made to shareholders of the company on the reduction of capital is treated as dividend to the extent the company possesses accumulated profits (whether capitalized or not).

(5) Payment by way of loan or advance to a shareholder / concern. [Section 2(22)(e)]

Under this clause, following two types of transactions are covered:

- (i) loan or advance to a shareholder to the extent company possesses accumulated profits.
- (ii) loan or advance to a concern to the extent company possesses accumulated profits.

(A) Loan or advance to a shareholder - Loan or advance to a shareholder is treated as dividend in the hands of shareholder if the following conditions are satisfied:

- a.** loan or advance is given by a company in which the public are not substantially interested (closely held company);

- b. loan or advance is given to a shareholder (being a person who is a registered shareholder as well as the beneficial owner of at least 10 per cent equity shares);
- c. the company must possess accumulated profits (excluding capitalized profits) at the time of granting loan or advance.

(B) Loan or advance to a concern: - Loan or advance to a concern is treated as a deemed dividend in the hands of the shareholder if the following conditions are satisfied:

- a. loan or advance is given by a company in which the public are not substantially interested (closely held company) to a concern;
- b. there is a shareholder (being a person who is a registered shareholder as well as the beneficial owner) who holds 10 percent equity share capital in the above-mentioned company;
- c. the abovementioned shareholder also has substantial interest in such concern;
- d. the company must possess accumulated profit (excluding capitalized profits) at the time of granting loan or advance.

Substantial Interest: A person, shall be deemed to have a substantial interest in a concern, if he is at any time during the previous year, beneficially entitled to at least 20 per cent of income of such concern.

Similarly, a person, shall be deemed to have a substantial interest in a company, if he is the beneficial owner of at least 20 per cent equity share capital of that company.

7.1A FEW DISTRIBUTIONS ARE NOT TREATED AS DIVIDEND

Section:- 2(22)

- (1) Any payment made by a company on purchase of its own shares in accordance with the provisions contained in section 77A of the Companies Act, 1956
- (2) Any distribution of shares made in accordance with the scheme of demerger by the resulting company to the shareholders of the demerged company whether or not there is a reduction of capital in the demerged company.
- (3) For the purpose of section 2(22) (c) and 2(22) (d), the following are not treated as dividend:
 - a. any distribution to preference shareholders when preference shares are issued for full cash consideration; and
 - b. any distribution to equity shareholders in respect of bonus shares allotted to them after March 31, 1964, but before April 1, 1965.
- (4) For the purpose of Section 2(22)(e), following payments are, however, not treated as dividend:
 - a. Any advance or loan made to a shareholder or a concern by a company in the ordinary course of its business, where money-lending is a substantial part of the business of the company. and
 - b. Any dividend paid by a company which is set off by the company against the whole or any part of any sum previously paid by it and treated as a dividend under section 2(22)(e).

7.2 | MEANING OF ACCUMULATED PROFITS**Section:-** Explanation 1, 2 and 2A of section 2(22) – Effective from A.Y. 2018-19

- (a) An accumulated profit does not include capital gains arising before April 1, 1946 and after March 31, 1948 but before April 1, 1956.
- (b) In case of a company, which is not in liquidation, it includes all profits of a company up to the date of distribution or payment.
- (c) In case of a company, which is in liquidation, it includes all profits of the company up to the date of liquidation.
- (d) In case of company, which is in liquidation consequent on the compulsory acquisition of a company's undertaking by the Government or a corporation owned or controlled by the Government, then accumulated profits do not include any profits of the company prior to the three successive years immediately preceding the previous year in which such acquisition took place
- (e) **In the case of an amalgamated company, accumulated profits or loss in the hands of the amalgamated company shall be increased by the accumulated profits of the amalgamating company (whether capitalized or not) on the date of amalgamation. [Inserted by Finance Act, 2018 w.r.e.f. A.Y. 2018-19].**

(A) Based on decisions of various courts, accumulated profit includes:

- Balance of Profit and loss account
- Current Profit
- General Reserve
- Development Rebate Reserve
- Investment Allowance Reserve
- Any other free Reserve e.g. Building Reserve Fund
- Additions made by Assessing Officer on account of concealed income
- Exempt Incomes
- Capital Gain chargeable to tax

(B) Based on decisions of various courts, accumulated profit does not include:

- Balancing Charge computed under section 41(2)
- Capital Gain not chargeable to tax
- Additions made by Assessing Officer in respect of inadmissible expenses
- Depreciation Reserve / Fund
- Provisions for taxation
- Proposed Dividend

Note:- For determining accumulated profits, depreciation as per Income tax Act has to be considered.**Practical 1**XYZ Ltd. is a company registered in India. The balance sheet of the company on March 31, **2019** is as under:

Liabilities	Rs.	Assets	Rs.
Preference share capital (issued for cash)	4,00,000	Fixed assets (before depreciation)	15,00,000
		Investment in share (market value Rs. 13,00,000)	4,00,000
Equity share capital			
- issued for consideration	6,00,000	Other assets	9,20,000

DIVISION B-FIVE HEADS OF INCOME, SET OFF, CLUB..**7 –INCOME FROM OTHER SOURCES**

- issued as bonus shares in 1960 and 1976 by capitalising profits	6,00,000		
General reserve	3,00,000		
Investment allowance reserve	90,000		
Depreciation reserve	1,00,000		
P & L A/c balance as on April 1, 2018:			
Rs.2,40,000			
Add: Profit of the year ending March 31, 2019	Rs. 60,000	3,00,000	
Provision for taxation and dividend	2,30,000		
Current liabilities	2,00,000		
	28,20,000		28,20,000

Additional Information:

- XYZ Ltd. took over ABC Ltd. on 1st April, 2018. The amalgamation was in the nature of merger.
- Profit and loss account balance on April 1, 2018 includes profit and loss account balance of ABC Ltd. Rs.30,000.
- General Reserve of Rs. 3,00,000 has been computed as under:

General Reserve of XYZ Ltd. before amalgamation	Rs.2,50,000
Add: General Reserve of ABC Ltd. (Amalgamating Co.) – The amalgamation was in nature of merger	Rs.1,50,000
Sub-Total	Rs.4,00,000
Less: Adjustment for amalgamation (The difference between the amount recorded as share capital issued and the amount of share capital of ABC Ltd. adjusted in reserves)	(Rs.1,00,000)
General Reserve as on 31-03-2019	Rs. 3,00,000

You are required to ascertain the accumulated profits of the company to apply the deeming fiction of Section 2(22).

7.3	SUM OF MONEY/PROPERTIES RECEIVED WITHOUT CONSIDERATION OR PROPERTIES RECEIVED FOR A CONSIDERATION WHICH IS LESS THAN FAIR MARKET VALUE OR STAMP DUTY, AS THE CASE MAY BE

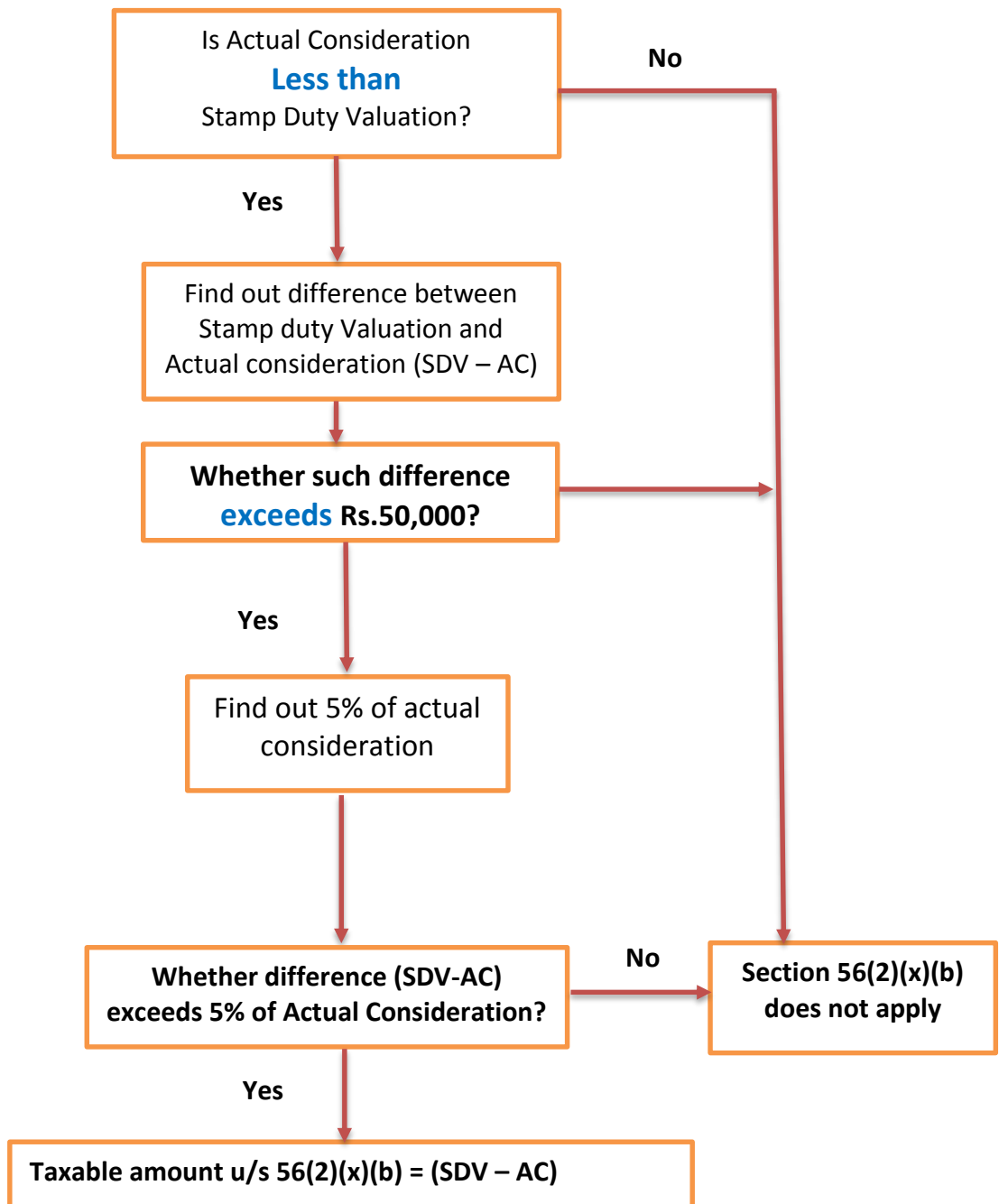
Section:- 56(2)(x)(b) – Substituted by Finance Act, 2018 Effective from A.Y.2019-20

Sub Clause (B) of section 56(2)(x) (b)

Transaction	Condition	Taxable amount
Immovable property received for a consideration.	the stamp duty value of such property as exceeds such consideration, if the amount of such excess is more than the higher of the following amounts, namely: (i) the amount of fifty thousand rupees; and (ii) the amount equal to five per cent of the consideration [Substituted by Finance Act, 2018 w.e.f. A.Y. 2019-20.]	Difference between stamp duty value and the consideration (This rule shall be applicable for each property separately)

Notes:

1. If there is a time gap between date of agreement and date of registration, **the stamp duty value may be taken as on the date of agreement** instead of the date of registration. However, for this purpose, at least a part of the consideration has been paid by way of an account payee cheque or account payee bank draft or by use of electronic clearing system through a bank account, on or before the date of agreement.
2. If assessee may dispute the stamp duty value of property on grounds mentioned under section 50C(2), then the assessing officer may refer the valuation of such property to the valuation officer, and the provisions of section 50C and section 155(15) shall apply accordingly for the purpose of sub clause (b) of Section 56(2)(x).

**Practical 2**

Ms. Radha would like to purchase flat. The valuation of this flat for the purpose of stamp duty is Rs. 25,00,000. Find out taxable amount under section 56(2)(x)(b), if any, under following alternatives, if actual consideration paid by her is:

Alternative I	Alternative II	Alternative III	Alternative IV
Rs.25,21,000	Rs. 24,70,000	Rs.24,00,000	Rs.23,00,000

7.4	COMPENSATION FOR TERMINATION OF EMPLOYMENT OR MODIFICATION OF THE TERMS AND CONDITIONS THERETO.

Section:- 56(2)(xi) – Inserted by Finance Act, 2018 – A.Y. 2019-20

Clause (xi) has been inserted in section 56(2) w.e.f. A.Y. 2019-20 to provide that any compensation or other payment, due to or received by any person, by whatever name called, in connection with the termination of his employment or the modification of the terms and conditions relating thereto shall be chargeable to tax under the head “Income from other sources”.

Conflict: Readers shall consider section 17(3) (i) which reads as under:

“the amount of any compensation due to or received by an assessee from his employer or former employer at or in connection with the termination of his employment or the modification of terms and conditions relating thereto” – shall be termed as “profits in lieu of salary”

7.5	SUM OF MONEY/PROPERTIES RECEIVED WITHOUT CONSIDERATION OR PROPERTIES RECEIVED FOR A CONSIDERATION WHICH IS LESS THAN FAIR MARKET VALUE OR STAMP DUTY, AS THE CASE MAY BE

Section:- 56(2)(x)

Following paragraphs deal with taxation of sum of money or properties received without consideration or properties received for a consideration which is less than fair market value or stamp duty, as the case may be.

Para No.	Description
Para 7.5	Sum of money/ properties received without consideration.
Para 7.5A	Exceptions / Relief from taxation
Para 7.5B	Meaning of Property
Para 7.5C	Determination of fair market value of Jewellery etc.
Para 7.5D	Determination of fair market value of Shares and Securities
Para 7.5E	What is the cost of acquisition if properties are subsequently sold?

Conditions for taxability:

If any person receives one or more of the following during the previous year from any other person, on or after the 1st day of April, 2017, then shall be regarded as income and subject to tax under this head:

(A) Sub Clause (a) of section 56(2)(x)

<i>Transaction</i>	<i>Condition</i>	<i>Taxable amount</i>
<i>Sum of money received without consideration</i>	<i>Aggregate amount received exceeds Rs.50,000</i>	<i>Aggregate amount received</i>

Practical 3

During concerned previous year, Mr. Krishna received following sum of money without consideration. Discuss tax consequences.

From	Rs.
Friend A	17,000
Friend B	14,000
Friend C	19,000

Solution

Mr. Krishna received exactly Rs.50,000 (not exceeding Rs. 50,000) without consideration. Therefore nothing shall be taxed in his hands.

Reader's Note:**Practical 4**

Suppose in the above problem, amount received from Friend C is Rs.19,001 instead of Rs. 19,000. Discuss tax consequences.

Solution

The aggregate amount received without consideration by Mr. Krishna is Rs.50,001 (exceeding Rs. 50,000), therefore, entire Rs. 50,001 shall be taxed in the hands of Mr. Krishna under the head "Income from other sources."

Reader's Note:**(B) Sub Clause (A) of section 56(2)(x)(b)**

<i>Transaction</i>	<i>Condition</i>	<i>Taxable amount</i>
<i>Immovable property received without consideration</i>	<i>Stamp duty value of immovable property exceeds Rs50, 000.</i>	<i>Stamp duty value of such property. (This rule shall be applicable for each property separately)</i>

Practical 5

During concerned previous year, Mr. Yudhisthir received following urban lands without consideration.

From	Valuation for Stamp Duty Purpose (Rs.)
Friend P	32,000
Friend Q	68,000

Solution

The valuation of land received from friend "P" does not exceed Rs. 50,000 (It is Rs. 32,000), therefore, it shall not be taxed in the hands of Mr. Yudhisthir. However, value of land received from friend "Q" exceeds Rs. 50,000 (It is Rs. 68,000), the same shall be taxed.

Reader's Note:**Practical 6**

Suppose in the above problem, land received from friend Q is an agricultural land instead of urban land. Discuss tax consequences.

Solution

Since land received from Friend Q is not a capital asset (in this case, it is an agricultural land), nothing shall be taxed in the hands of Mr. Yudhisthir even though value of this land exceeds Rs. 50,000.

Reader's Note:**(C) Sub Clause (B) of section 56(2)(x) (b)**

<i>Transaction</i>	<i>Condition</i>	<i>Taxable amount</i>
<i>Immovable property received for a consideration.</i>	<i>the stamp duty value of such property as exceeds such consideration, if the amount of such excess is more than the higher of the following amounts, namely: (i) the amount of fifty thousand rupees; and</i>	<i>Difference between stamp duty value and the consideration (This rule shall be applicable for</i>

(ii) the amount equal to five per cent of the consideration: [Amended by Finance Act, 2018 w.e.f. A.Y. 2019-20.]	each property separately)

Notes:

1. If there is a time gap between date of agreement and date of registration, **the stamp duty value may be taken as on the date of agreement** instead of the date of registration. However, for this purpose, at least a part of the consideration has been paid by way of an account payee cheque or account payee bank draft or by use of electronic clearing system through a bank account, on or before the date of agreement.
2. If assessee may dispute the stamp duty value of property on grounds mentioned under section 50C(2), then the assessing officer may refer the valuation of such property to the valuation officer, and the provisions of section 50C and section 155(15) shall apply accordingly for the purpose of sub clause (b) of Section 56(2)(x).

Practical 7

Shweta purchased flat from Rahul, details of which are as under:

1. Date of entering into agreement :-1.7.2018.
2. Agreed consideration : Rs. 100 lakhs
3. Down payment of Rs. 15 lakhs was paid by cheque on the date of agreement.
4. Stamp duty value of flat on the date of agreement was Rs. 135 lakhs.
5. Registration of sale deed in respect of flat took place on 1.1.2019.
6. Stamp Duty value on the date of registration of sale deed was Rs. 150 lakhs.

Discuss tax implications in the hands Shweta.

Solution**(1) Taxable Amount under the head “Income from Other Sources”**

Taxable Amount = Stamp Duty Value Less Actual Consideration
 = Rs.135 lakhs – Rs.100 lakhs
 = Rs. 35 lakhs

- (2)** Further, Shweta shall deduct TDS under section 194 IA at 1 % of consideration (Readers must note that 1% is not of stamp duty value, it is of consideration). Therefore, Shweta shall deduct TDS of Rs. 1,00,000/- while making payment to Rahul.

Reader’s Note:**(D) Sub Clause (A) of section 56(2)(x) (c)**

Transaction	Condition	Taxable amount
Movable property received without consideration	Aggregate fair market value of movable properties exceeds Rs 50,000	fair market value on aggregate basis

Practical 8

During concerned previous year, Mr. Arjuna received following properties without consideration. Discuss tax consequences.

Description of Property	Fair Market Value (Rs.)
Jewelry from friend M	27,000
Archeological Collections from friend N	14,000
Mobile from friend O	15,000

Solution

Description of Property	Fair Market Value (Rs.)
Jewelry from friend M	27,000
Archeological Collections from friend N	14,000
Mobile from friend O (Not covered within the meaning of property)	-
Aggregate	41,000

Since aggregate amount does not exceed Rs. 50,000, nothing is taxable in the hands of Mr. Arjuna.

Reader's Note:**(E) Sub Clause (B) of section 56(2)(x) (c)**

Transaction	Condition	Taxable amount
Movable property received for a consideration which is less than the aggregate fair market value.	Consideration is less than the aggregate fair market value of properties by an amount exceeding Rs 50,000	Difference between fair market value and consideration on aggregate basis

Practical 9

During concerned previous year, Mr. Bhima purchased following properties. Discuss the tax consequences.

Particulars	Fair Market Value (Rs.)	Purchase Price
Golden Ring	78,000	72,000
L.C.D. Television	42,000	32,000
Paintings	1,00,000	61,000

Solution

Particulars	Fair Market Value (Rs.)	Purchase Price (Rs.)	Difference (Rs.)
Golden Ring	78,000	72,000	6,000
L.C.D. Television (Not covered within the meaning of property)	-	-	-
Paintings	1,00,000	61,000	39,000
Aggregate of Difference			45,000

Since aggregate amount does not exceed Rs. 50,000, nothing is taxable in the hands of Mr. Bhima.

Reader's Note:**Practical 10**

Suppose in the above problem painting was purchased for Rs.51,000 instead of Rs. 61,000. Discuss the tax consequences.

Solution

Particulars	Fair Market Value (Rs.)	Purchase Price (Rs.)	Difference (Rs.)
Golden Ring	78,000	72,000	6,000
L.C.D. Television (Not covered within the meaning of property)	-	-	-
Paintings	1,00,000	51,000	49,000
Aggregate of Difference			55,000

Since aggregate amount exceeds Rs. 50,000, entire difference of Rs. 55,000 is taxable in the hands of Mr. Bhima.

Reader's Note:

Practical 11

Mr. Nakula provides the following information for the concerned previous year. Discuss the tax consequences.

- (i) Received gift of Rs. 48,000 from friend X.
- (ii) Received house property without consideration from friend's grandmother, valuation of the same for stamp duty purpose was Rs. 42,000.
- (iii) Purchased urban land for Rs. 11,82,000 though the value of the same for stamp duty purpose was Rs. 11,00,000.
- (iv) Received gift of shares worth Rs. 29,000
- (v) Purchased sculpture for Rs.9,000 though fair market value was Rs.49,000

Solution**Tax Consequences in the hands of Mr. Nakula**

Sr. No.	Particulars	Relevant Para Applicable (Rs.)				
		Para 7.12 (A)	Para 7.12 (B)	Para 7.12 (C)	Para 7.12 (D)	Para 7.12 (E)
(i)	Received Cash	48,000				
(ii)	Received House property without consideration		42,000			
(iii)	Purchased Urban land			Refer Note		
(iv)	Gift of Shares				29,000	
(v)	Sculpture					40,000
	Which rule Applicable- Aggregation or each transaction?	Aggregate	Each transaction	Each transaction	Aggregate	Aggregate
	Aggregate	48,000	NA	NA	29,000	40,000
	Taxability	Not Taxable	Not Taxable	Not Taxable	Not Taxable	Not Taxable

Reader's Note:

Note: Section 56 is not applicable since Nakula purchased land for a value more than the value adopted for stamp duty purpose.

7.5A EXCEPTIONS / RELIEF FROM TAXATION**Section:-** Proviso to section 56(2)(vii)

While calculating the above monetary limit of Rs. 50,000, any sum of money/properties received from the following shall not be considered.

1. Any sum of Money/properties which is received from any relative
2. Any sum of Money/properties which is received on the occasion of the marriage of the individual.
3. Any sum of Money/properties which is received under a will or by way of inheritance.
4. Any sum of Money/properties which is received in contemplation of death of the payer.
5. Money/properties received from a local authority

6. Money/properties received from any fund, foundation, university, other educational institution, hospital, medical institution, any trust or institution referred to in section 10(23C).
7. Money/properties received from a charitable institute registered under section 12AA.
8. Money/properties received by way of transaction not regarded as transfer under clause (vib) or clause (vid) or clause (vii) of section 47. [i.e., receipt of money/ properties in a scheme of amalgamation, demerger, etc.]
9. Capital asset received by way of transaction not regarded as transfer *under clause (i) or [clause (iv) or clause (v) or -i.e., transfer of capital asset between holding and its 100 per cent subsidiary companies or vice versa provided the transferee-company is an Indian Company, etc. – Amended by Finance Act, 2018 w.e.f A.Y. 2019-20.] clause (vi) or clause (via) or clause (viaa) or clause (vib) or clause (vic) or clause (vica) or clause (vich) or clause (vid) or clause (vii) of section 47.*
10. Money / properties received by a trust from an individual where trust is created or established solely for the benefit of relative of the individual.

Meaning of relative in relation to “Individual” -For the aforesaid purpose, the term "relative" in relation to “Individual” means—

1. Spouse of the individual
2. Brother or sister of the individual
3. Brother or sister of the spouse of the individual
4. Brother or sister of either of the parents of the individual
5. Any lineal ascendant or descendant of the individual
6. Any lineal ascendant or descendant of the spouse of the individual
7. Spouse of the person referred to in (2) to (6)

Meaning of relative in relation to “HUF” - For the aforesaid purpose, the term "relative" in relation to “HUF” means any member thereof.

That means any sum of money or property received without consideration or for an inadequate consideration by an HUF from its members will not be subject to tax.

Practical 12

Mr. Jayesh received gift of Rs. 1, 00,000 from his uncle. Discuss tax consequences in the hands of Mr. Jayesh.

Solution

Mr. Jayesh received Rs.1,00,000 from his uncle who falls under the definition of relative for Mr. Jayesh. Any sum of money / property received from relative does not fall under section 56(2)(vii), therefore, nothing shall be taxed in the hands of Mr. Jayesh.

Reader’s Note:

Practical 13

Mr. Uncle received gift of Rs. 1,00,000 from his nephew. Discuss tax consequences in the hands of Mr. Uncle.

Solution

Mr. Uncle received Rs.1,00,000 from his nephew who does not fall under the definition of relative for Mr. Uncle. And amount received exceeds Rs. 50,000 therefore entire Rs. 1,00,000 shall be taxed in the hands of Mr. Uncle.

Reader’s Note:

Practical 14

Mr. Manmoji received gold from various persons without consideration. The fair market value of gold is Rs. 1,25,000. Discuss tax consequences in the hands of Mr. Manmoji under following alternatives:-

Alternative (a) : Mr. Manmoji received gold on occasion of his marriage.

Alternative (b) : Mr. Manmoji received gold on his 25th marriage anniversary.

Solution**Alternative (a)**

For the purpose of section 56(2)(vii), any sum of money/properties received on the occasion of the marriage of the individual shall excluded.

Therefore, gold received on the occasion of marriage by Mr. Manmoji is not taxable.

Alternative (b)

As discussed above, For the purpose of section 56 (2)(vii), any sum of money/properties received on the occasion of the marriage of the individual shall excluded. However it does not exclude any money/properties received on the occasion of marriage anniversary from non-relative.

Therefore, gold receive worth Rs. 1,25,000 (exceeding Rs. 50,000) on the occasion of 25th marriage anniversary shall be chargeable to tax in the hands of Mr.Manmoji.

Reader's Note:**7.5B MEANING OF PROPERTY****Section:- 56(2)(vii)**

“Property” means capital asset of the assessee being

- (i) immovable property being land or building or both;
- (ii) shares and securities;
- (iii) jewellery;
- (iv) archaeological collections;
- (v) drawings;
- (vi) paintings;
- (vii) sculptures;
- (viii) any work of art;
- (ix) *bullion*;

Practical 15

During concerned previous year, Mr. Sahdev received 1,000 shares of WIPRO Limited from his friend, without consideration. Fair market value of this shares on the date of gift was Rs. 2,500 per share. Discuss tax consequences in the hands of Sahdev under following alternatives:-

Alternative (a): Mr. Sahdev is a share trader

Alternative (b): Mr. Sahdev is not a share trader

Solution

On minute reading of the definition of property, it shall be taxed in the hands of recipient only if it is a capital asset for the recipient.

Alternative (a):- In this alternative, Mr. Sahdev is a share trader and if he treats the shares of WIPRO Limited received by him from his friend as a part of stock-in-trade (not a capital asset), then nothing shall be taxed under section 56(2)(x)(c)(A)

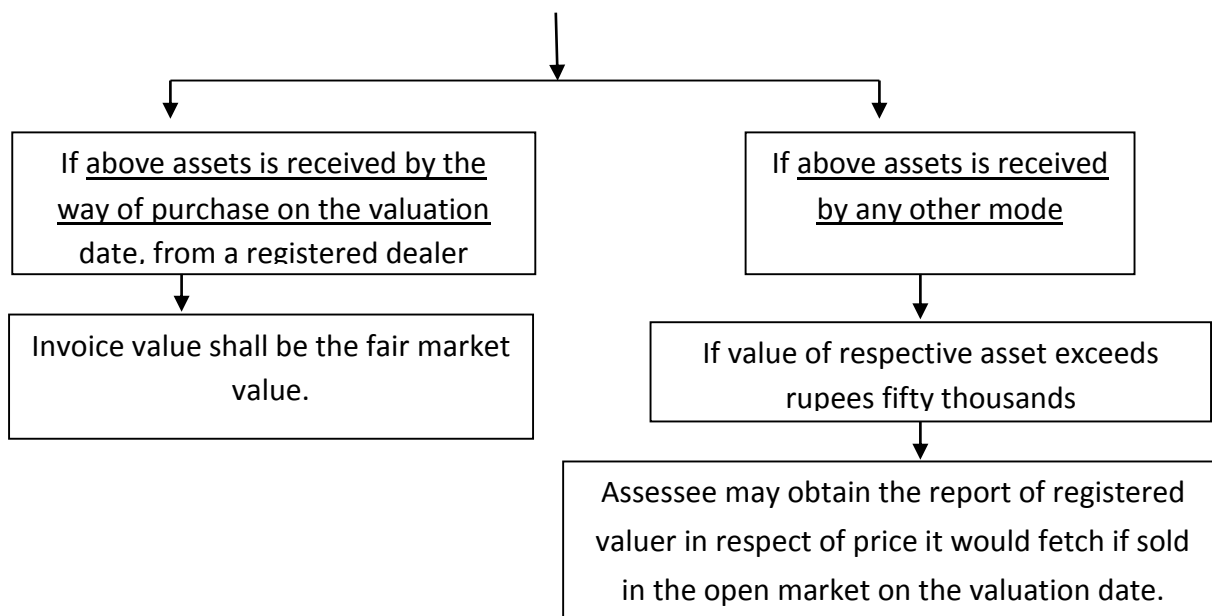
Alternative (b):- In this alternative, Mr. Sahdev is not a share trader and therefore, shares of WIPRO Limited received by him from his friend are capital asset. Hence, Rs. 25,00,000 (Fair market value) shall be taxed under section 56(2)(x)(c)(A).

Reader's Note:

7.5C DETERMINATION OF FAIR MARKET VALUE OF JEWELLERY, DRAWINGS ETC.

Rule:- 11 U, 11 UA

The FMV of jewellery, archeological collections, drawings, paintings, sculptures or any work of art shall be estimated to be price which it would fetch if sold in the open market on the valuation date: Consider following chart:-



Relevant definitions:

1) Registered dealer

“registered dealer” means a dealer who is registered under Central Sales tax Act, 1956 or General Sales-tax Law for the time being in force in any State including value added tax laws.

2) Registered valuer

“Registered valuer” shall have the same meaning as assigned to it in section 34AB of the Wealth Tax Act, 1957 read with rule 8A of wealth-tax Rules, 1957.

3) Valuation date

“valuation date” means the date on which the property is received by the assessee.

Practical 16

Ms. Jaya purchased diamond jewellery from “Abhushan” Jewellers, a registered dealer under Gujarat VAT Act for Rs. 55,000. Similar jewellery was purchased by Ms. Chhaya on the same day from “Kalyan Jewellers”, a registered dealer under Gujarat VAT Act for Rs. 62,000. Find out fair market value for the purpose of section 56 in the hands of Ms. Jaya and Ms. Chhaya under following alternatives:-

Alternative (a): Both Ms. Jaya and Ms. Chhaya have obtained the invoice from respective jewellers.

Alternative (b): Both Ms. Jaya and Ms. Chhaya have not obtained the invoice from respective jewellers

Alternative (c): Both Ms. Jaya and Ms. Chhaya have obtained the invoice from respective jewellers but both the jewellers are unregistered.

Solution

Alternative (a): Both Ms. Jaya and Ms.Chhaya have obtained the invoice from respective jewellers.

If diamond is purchased from a registered dealer by obtaining invoice, then as per valuation rule, invoice value shall be the fair market value.

Therefore, respective invoice value of the diamond shall be the fair market value in the hands of Ms. Jaya and Ms. Chhaya.

Alternative (b):Both Ms. Jaya and Ms.Chhaya have not obtained the invoice from respective jewellers

If diamond is purchased from a registered dealer without obtaining invoice, then as per valuation rules, assessee may obtain the report of registered valuer in respect of fair market value of diamond on the date of purchase.

Alternative (c): Both Ms. Jaya and Ms.Chhaya have obtained the invoice from respective jewellers but both the jewellers are unregistered.

If Diamond is purchase from a unregistered dealer, then as per valuation rules, assessee may obtain the report of registered valuer in respect of fair market value of diamond on the date of purchase.

Reader's Note:

Practical 17

Ms. Kamli purchased gold jewellery from "Gharana Jewellers", being unregistered dealer for Rs. 45,000. Further, she purchased painting from "Modern Art" being unregistered dealer for Rs. 38,000. Is Ms. Kamli required to obtain report of registered valuer?

Solution

On reading of valuation rule, Ms. Kamli required to obtain report of registered valuer only when the value of respective asset exceeds Rs.50,000. In this case, value of each asset (i.e. jewellery and painting) does not exceed Rs.50,000, therefore, Ms Kamli is not required to obtain report from registered valuer.

Reader's Note:

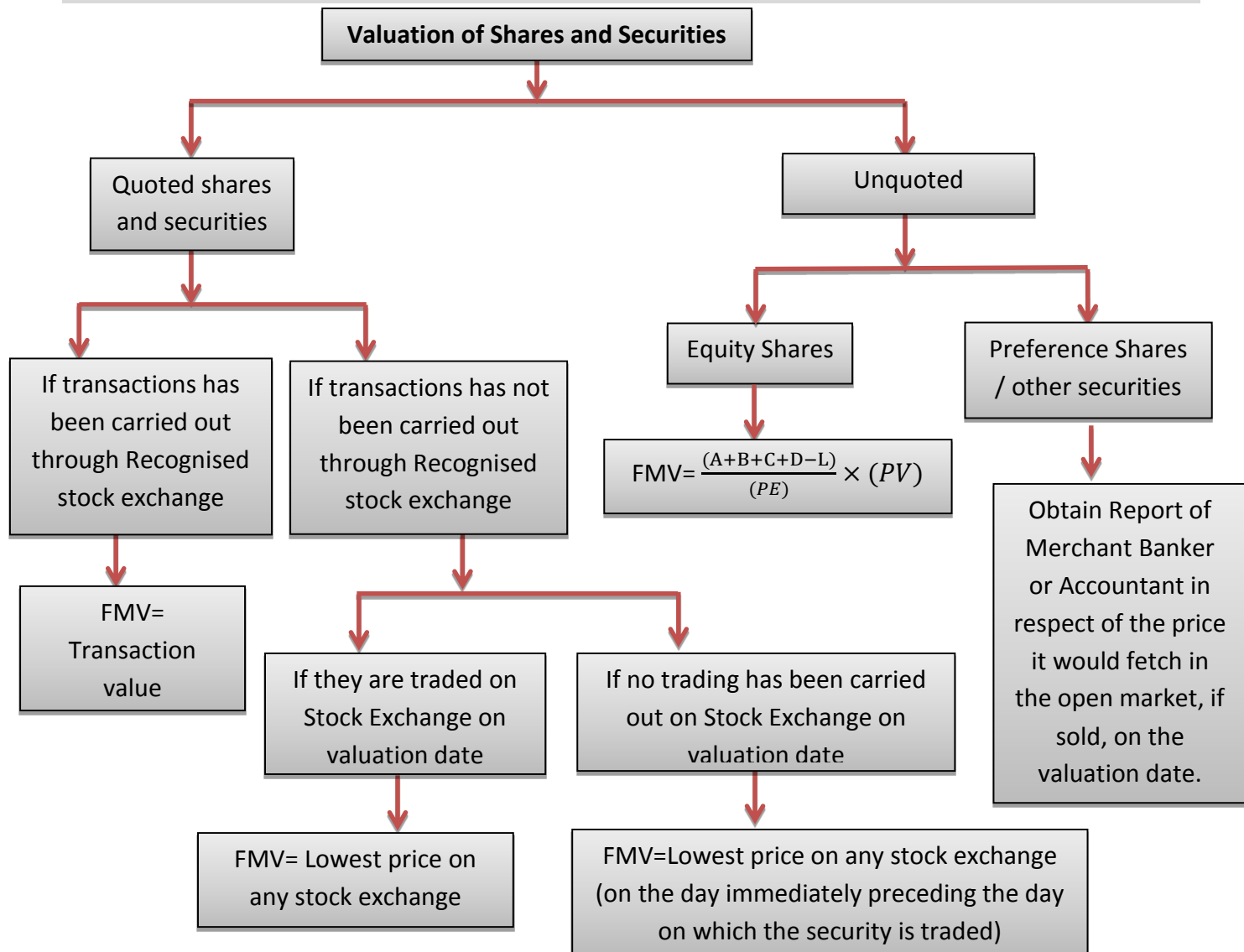
Practical 18

Mr. Viru purchased painting on **5th May, 2018** from registered dealer for Rs.1, 00,000 and obtained the invoice of same. He gifted this painting to Miss Mohmaya on **9th September 2018**. Fair market value of this painting, as per registered valuer report on **9th September, 2018** was Rs.1, 25,000. Discuss taxability of this transaction in the hands of Miss Mohmaya.

Solution

Miss Mohmaya has received paintings without consideration, therefore, fair market value of painting on the date of gift (i.e. Rs.1,25,000) shall be chargeable to tax in her hands.

Reader's Note:

7.5D DETERMINATION OF FAIR MARKET VALUE OF SHARES AND SECURITIES**RULE:- 11U, 11UA****Meaning of various terms used in the above valuation rule:**

A= book value of all the assets (other than jewellery, artistic work, shares, securities and immovable property) in the balance-sheet as reduced by,-

(i) any amount of income-tax paid, if any, less the amount of income-tax refund claimed, if any; and

(ii) any amount shown as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset;

B = the price which the jewellery and artistic work would fetch if sold in the open market on the basis of the valuation report obtained from a registered valuer;

C = fair market value of shares and securities as determined in the manner provided in this rule;

D = the value adopted or assessed or assessable by any authority of the Government for the purpose of payment of stamp duty in respect of the immovable property;

L= book value of liabilities shown in the balance sheet, but not including the following amounts, namely:—

(i) the paid-up capital in respect of equity shares;

(ii) the amount set apart for payment of dividends on preference shares and equity shares where such dividends have not been declared before the date of transfer at a general body meeting of the company;

(iii) reserves and surplus, by whatever name called, even if the resulting figure is negative, other than those set apart towards depreciation;

(iv) any amount representing provision for taxation, other than amount of income-tax paid, if any, less the amount of income-tax claimed as refund, if any, to the extent of the excess over the tax payable with reference to the book profits in accordance with the law applicable thereto;

(v) any amount representing provisions made for meeting liabilities, other than ascertained liabilities;

(vi) any amount representing contingent liabilities other than arrears of dividends payable in respect of cumulative preference shares;

PV= the paid up value of such equity shares;

PE = total amount of paid up equity share capital as shown in the balance-sheet;”

Relevant definitions

- (a) "accountant" shall have the same meaning as assigned to it in the Explanation below sub-section (2) of section 288 of the Act;
- (b) The balance-sheet in relation to any company means balance sheet of such company (including the notes annexed thereto and forming part of the accounts) as drawn up on the valuation date which has been audited by the auditor appointed u/s 224 of the Companies Act, 1956(1 of 1956);
- (c) "Merchant banker" means category I merchant banker registered with Security and Exchange Board of India established under section 3 of the Securities and Exchange Board of India Act, 1992 (15 of 1992);
- (d) "quoted shares or securities" in relation to share or securities means a share or security quoted on any recognized stock exchange with regularity from time to time, where the quotations of such shares or securities are based on current transaction made in the ordinary course of business;
- (e) "recognized stock exchange" shall have the same meaning as assigned to it in clause (f) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956);
- (f) "securities" shall have the same meaning as assigned to it in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956);
- (g) "unquoted shares and securities", in relation to shares or securities, means shares and securities which is not a quoted shares or securities;
- (h) "valuation date" means the date on which the property is received by the assessee.

Practical 19

Mr. Abhishek gifted 10,000 unquoted shares of Ajitabh Bachhan Corporation Limited (ABCL) to Dr. Deval on **10th July, 2018**. Find out amount, if any, to be taxed in the hands of Dr. Deval under the head "Income from other sources".

Balance Sheet of ABCL on 10th July, 2018

Liabilities	Rs. In crores	Assets	Rs. In crores
30,00,000 equity shares of Rs.10 each	3.00	Fixed Assets	10.00

DIVISION B-FIVE HEADS OF INCOME, SET OFF, CLUB..**7 –INCOME FROM OTHER SOURCES**

12% Cumulative Preference shares	2.00	Investments	2.00
Reserves and Surplus	1.50	Current Assets	2.00
Loan funds	2.50		
Current liabilities	5.00		
	14.00		14.00

Additional information:

- (i) Fixed assets represents immovable properties of the company and the valuation assessable for the purpose of stamp duty for these assets is Rs. 25 Cr.
- (ii) Investment represents investment in shares and securities, the fair market value of such investments in accordance with Rule 11UA is Rs. 3.5 Cr.
- (iii) Current Asset includes advance tax Rs.50 lakh.
- (iv) Current liability includes
 - a. Provision for unascertained liability Rs. 30 lakhs
 - b. Proposed dividend Rs.10 lakhs.
- (v) Reserve and Surplus includes Depreciation Reserve Rs. 22.50 lakhs
- (vi) Further, company reported contingent liabilities Rs. 55 lakhs which includes unpaid preference dividend of one year.

Solution

Amount to be taxed in the hands of Dr. Deval = 10,000 shares x Rs. 68.12 = Rs.6,81,200

Working Notes:**Calculation of Fair Market Value as on 10th July, 2018**

$$\begin{aligned}
 \text{Fair Market Value} &= \frac{(A+B+C+D-L)}{PE} \times PV \\
 &= \frac{(1.5 \text{ Cr} + \text{Nil} + 3.50 \text{ Cr} + 25 \text{ Cr} - 9.565 \text{ Cr})}{3.00 \text{ Cr}} \times 10 \\
 &= \text{Rs. 68.12 per share}
 \end{aligned}$$

Calculation of Assets (A)

Particulars	Rs.in crores
Total Assets	14.00
Less: Fixed Assets	(10.00)
Less: Investments	(2.00)
Less: Advance Tax	(0.50)
Assets (A)	1.50

Calculation of Assets (B) = the price which the jewellery and artistic work would fetch if sold in the open market on the basis of the valuation report obtained from a registered valuer = **NIL**

Calculation of Assets (C) = fair market value of shares and securities as determined in the manner provided in this rule = **Rs. 3.5 Cr**

Calculation of Assets (D) = the value assessable by any authority of the Government for the purpose of payment of stamp duty in respect of the immovable property = **Rs. 25Cr.**

Calculation of Liabilities (L)

Particulars	Rs.in crores
Total Liabilities	14.00
Less:(1) Paid up equity share capital	(3.00)
(2) Provisions for unascertained liabilities	(0.30)

(3) Proposed dividend	(0.10)
(4) Reserves and surplus (other than depreciation reserve)	(1.275)
Add: Unpaid Preference share dividend	0.24
Liabilities (L)	9.565

Calculation of PE

PE = Total amount of paid up equity share capital as shown in the balance sheet

= **Rs. 3.00 crores**

Calculation of PV

PV = the paid value of equity share = **Rs.10**

Reader's Note:

7.5E WHAT IS THE COST OF ACQUISITION IF PROPERTIES ARE SUBSEQUENTLY SOLD?

Section:- 49(4) and 49(1)

Particulars	Section Applicable	Cost of acquisition	Period of holding
Gift transaction – taxable under section 56(2)	Section 49(4)	Value adopted for purpose of section 56	Period of holding of previous owner not included
Gift transaction – not taxable under section 56 (2)	Section 49(1)	Cost to the previous owner	Period of holding of previous owner included

Practical 20

Mr. Surya purchased diamond ring for Rs. 38,000 on **09-09-15**. He gifted the same to Miss Maya on **14-02-2018**, on that day fair market value of this diamond ring was Rs. 48,000. It is the only gift received by Miss Maya during previous year 2017-18. After break-up with Mr. Surya, Miss Maya sold out this diamond ring for Rs. 52,000 on **12-12-18**. Discuss tax consequences in the hands of Miss Maya.

Cost of Inflation Index

2015-16: 254

2018-19: 280

Solution

In the hands of Miss Maya

(1) Taxability for the P.Y. 2017-18

Aggregate fair market value of gift received by Miss Maya does not exceed Rs. 50,000 therefore, nothing is taxable for the previous year 2017-18.

(2) Taxability for the P.Y. 2018-19

Period of Holding: 09-09- 2015 to 12-12- 2018	
Nature of Capital Asset: Long Term	
Particulars	(Rs.)
Full value of consideration	52,000
Less: Expenses in connection with Transfer	-
Net Consideration	52,000
Less: Cost of acquisition $\left(38,000 \times \frac{280}{254}\right)$	(41,890)
Long Term Capital Gain	10,110

Reader's Note:

Practical 21

Suppose in the above problem Miss Maya also received gift of gold ornament worth Rs. 22,000 on **30-03-2018** from another boy-friend Mr. Prakash. Discuss tax consequences assuming that she sold out diamond ring received from Mr. Surya as per the information given in above problem.

Solution**(1) Taxability for the P.Y. 2017-18**

Particulars	Fair Market Value (Rs.)
Diamond Ring from Mr. Surya	48,000
Gold Ornament from Mr. Prakash	22,000
Aggregate	70,000

Aggregate fair market value of gift received by Miss Maya exceeds Rs. 50,000 therefore, Rs.70,000 shall be taxed for the previous year **2017-18**

(2) Taxability for the P.Y. 2018-19

Period of Holding: 14-02-2018 to 12-12-2018

Particulars	Rs.
Full value of consideration	52,000
Less: Cost of acquisition u/s 49(4)	(48,000)
Short Term Capital Gain	4,000

Reader's Note:

7.6 SHARE PREMIUM IN EXCESS OF THE FAIR MARKET VALUE TO BE TREATED AS INCOME

Section:- 56(2)(viib), Rule 11UA(2)

(A) Applicability

This sub-clause is applicable to a company in which the public are not substantially interested.

(B) TaxabilityConditions

1. It receives consideration for issue of shares from a resident person.
2. The consideration received for issue of shares exceeds the face value of such shares. (i.e. shares are issued at a premium).
3. The aggregate consideration received for such shares exceeds the fair market value of the shares.

If all the above mentioned conditions are satisfied then following shall be chargeable to income-tax in the hands of closely held company under section 56(2)(viib) under the head "Income from other sources".

Taxable Amount = Aggregate consideration received for shares (less) fair market value of shares.

Practical 22

Discuss the applicability of the provisions of section 56(2)(viib) in respect of the shares issued by the following closely held companies to resident Indians –

Company	Consideration received for issue of a share	Face value of a share	Fair Market Value (FMV) of a share	Number of shares issued
	(Rs.)	(Rs.)	(Rs.)	(Rs.)
ABC (P) Ltd.	170	100	150	1,00,000
DEF (P) Ltd.	130	100	150	2,00,000
PQR (P) Ltd.	290	300	280	3,00,000

Solution

Company	Face value of a share	Fair Market Value (FMV) of a share	Consideration received for issue of a share	Applicability of section 56(2)(viib)
	(Rs.)	(Rs.)	(Rs.)	(Rs.)
ABC (P) Ltd.	100	150	170	The provisions of section 56(2)(viib) are attracted in this case since the shares are issued at a premium (i.e., issue price exceeds the face value of shares). The excess of the issue price of the shares over the FMV would be taxable under section 56(2)(viib).i.e., Rs. 20 lakh, being Rs. 20 (Rs.170 – Rs. 150) per share × 1,00,000 shares, shall be treated as income in the hands of ABC (P) Ltd.
DEF (P) Ltd.	100	150	130	The provisions of section 56(2)(viib) are attracted since the shares are issued at a premium. However, no sum shall be chargeable to tax under the said section in the hands of DEF (P) Ltd. as the shares are issued at a price less than the FMV of shares.
PQR (P) Ltd.	100	80	190	Section 56(2)(viib) is not attracted since the shares are issued at a discount, though the issue price is greater than the FMV.

Reader's Note:**(C) Exception:**

However, provision of this section shall not apply in the following two cases –

- where the consideration for issue of shares is received by a venture capital undertaking from a venture capital company or a Venture capital fund; or
- where the consideration for issue of shares is received by a company from a class or classes of person notified by the Central Government. (Resident “start up” company has been notified for this purpose- vide notification no. 45/2016)

(D) Meaning of Fair Market Value

The fair market value of the shares shall be the higher of the value—

- (a)** as may be determined in accordance with the method as may be prescribed; [Refer Rule 11UA(2) given below]

Rule 11UA (2):-

The fair market value of unquoted equity shares shall be :-

(1) $(A+B+C+D-L) * (PV) / (PE)$

Or

(2) *The fair market value of the unquoted equity shares determined by a merchant banker or an accountant as per the Discounted Free Cash Flow method.*

whichever is higher:

- (b)** as may be substantiated by the company to the satisfaction of the Assessing Officer, based on the value of its assets, including intangible assets, being goodwill, know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature.

Meaning of certain terms used for Rule 11 UA (2):

- (i) *"balance-sheet", in relation to any company, means the balance-sheet of such company (including the notes annexed thereto and forming part of the accounts) as drawn up on the valuation date which has been audited by the auditor of the company appointed under section 224 of the Companies Act, 1956 (1 of 1956)*
- and*
- (ii) *where the balance-sheet on the valuation date is not drawn up, the balance-sheet (including the notes annexed thereto and forming part of the accounts) drawn up as on a date immediately preceding the valuation date which has been approved and adopted in the annual general meeting of the shareholders of the company;*
- (iii) "accountant" means a fellow of the Institute of Chartered Accountants of India within the meaning of the Chartered Accountants Act, 1949 (38 of 1949) who is not appointed by the company as an auditor under section 44AB of the Act or under section 224 of the Companies Act, 1956 (1 of 1956);
- (iv) Valuation date: "valuation date" means the date on which consideration is received by the assessee.
- (v) Term "A", "B", "C", "D", "L", "PV" and "PE" has same meaning as assigned in earlier valuation rules.

7.7

COMPENSATION FOR TERMINATION OF EMPLOYMENT OR MODIFICATION OF THE TERMS AND CONDITIONS THERETO.

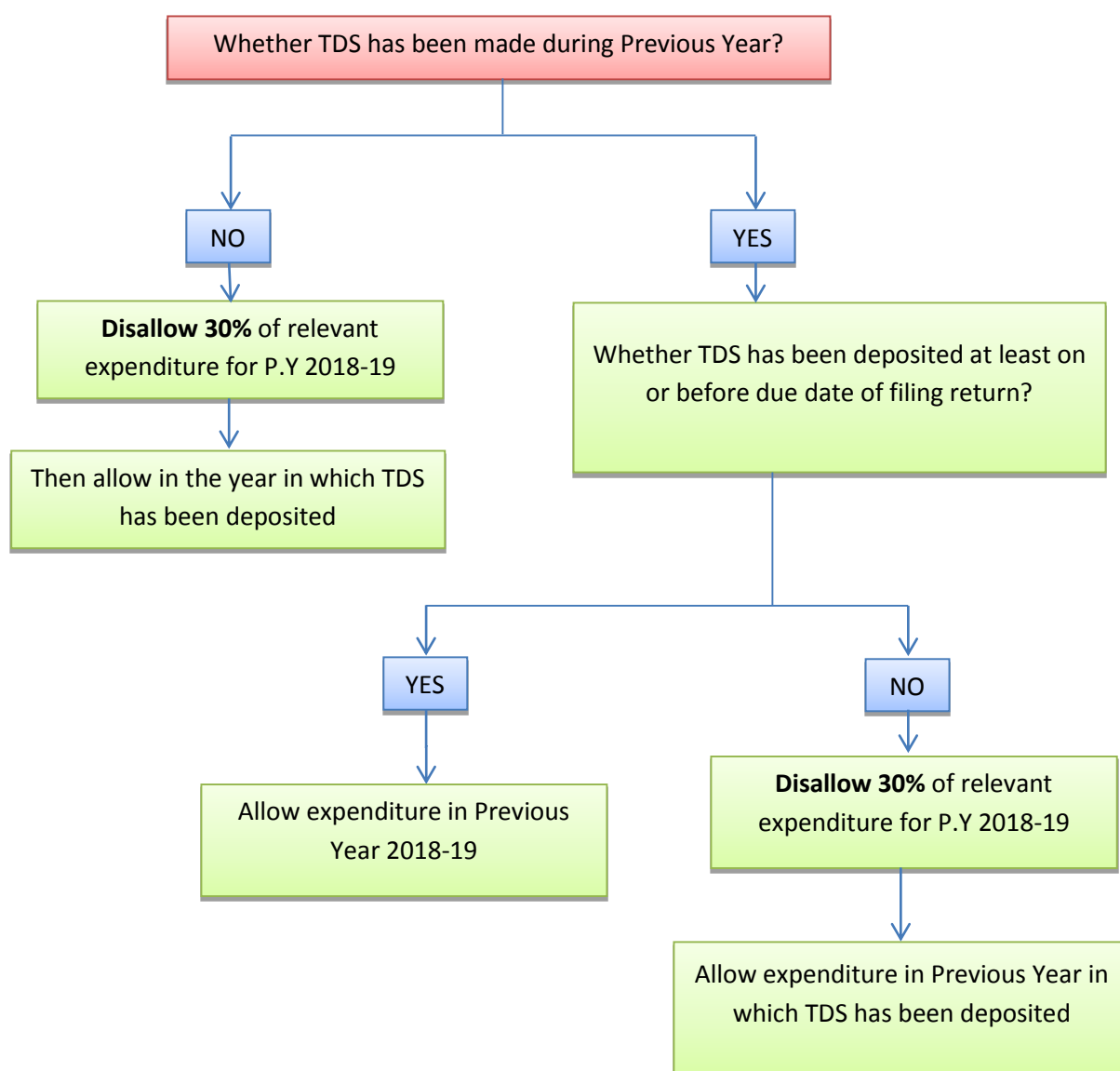
Section:- 56(2)(xi) – Inserted by Finance Act, 2018 – A.Y. 2019-20

Clause (xi) has been inserted in section 56(2) w.e.f A.Y. 2019-20 to provide that any compensation or other payment, due to or received by any person, by whatever name called, in connection with the termination of his employment or the modification of the terms and conditions relating thereto shall be chargeable to tax under the head "Income from other sources".

7.8 | DISALLOWANCE FOR TDS DEFAULT EXTENDED TO INCOME TAXABLE UNDER THE HEAD "INCOME FROM OTHER SOURCES"

Section:- 58(1A) – Effective from A.Y. 2018-19

With a view to improving compliance of provision relating to TDS, section 58(1A) has been amended (w.e.f. A.Y. 2018-19) so as to provide that provisions of section 40(a)(ia) shall, so far as they may be, apply in computing income chargeable under the head "Income from other sources" as they may be, apply in computing income chargeable under the head "Profit and Gains from Business or Profession."



8 – CLUBBING OF INCOME

9 – SET OFF AND CARRY OF LOSSES

9.1 RESTRICTIONS ON SET - OFF OF LOSS FROM HOUSE PROPERTY

Section:- 71(3A) – Effective from A.Y.2018-19

Sub- section (3A) has been inserted under section 71 which provides as under:

Where in respect of any A.Y., the net result of the computation under the head "Income from house property" is a loss and the assessee has income assessable under any other head of income, the assessee shall not be entitled to set off such loss, to the extent the amount of the loss exceeds Rs.2,00,000, against income under the other head.

Practical 1

Mr. Laxman provides following information about his income:

Particulars	A.Y. 2018-19 (Rs.)	A.Y. 2019-20 (Rs.)
Business income	30,00,000	50,00,000
FD interest income	3,00,000	3,40,000
Income under the head "House Property"	(-) 4,60,000	3,70,000
Invested in PPF	1,50,000	1,50,000

Find out the total income of Mr. Laxman for A.Y. 2018-19 and 2019-20. Also ascertain losses to be carried forward.

Solution**Computation of Total Income for A.Y. 2018-19**

Particulars	Rs.
Income under the head house property	(-)4,60,000
Income under the head PGBP	30,00,000
Income from other sources	3,00,000
Gross Total Income (Refer Note)	31,00,000
Less: Deduction under section 80C	1,50,000
Total Income	29,50,000
House Property loss to be carried forward to next 8 years (it can be set off only against the income under head house property of next 8 years)	2,60,000

Note: In view of the amendment made by Finance Act, 2017 under section 71(3A), set-off of loss under the head "Income from house property" against any other head of income shall be restricted to Rs.2 Lakh.

Computation of Total Income for A.Y. 2019-20

Particulars	Rs.	Rs.
Business Income		50,00,000
Income from house property (Let out)	3,70,000	
Less: B/f loss under section 71B (see Note)	(2,60,000)	1,10,000
Income from other sources		3,40,000
Gross Total Income		54,50,000
Less: Deduction under section 80C		1,50,000
Total Income		54,00,000

Note: Section 71B has not been amended. Brought forward house property loss can be adjusted in the current year against income under the head house property even if a quantum of b/f loss is more than Rs.2,00,000.

Readers Note:

10 – DEDUCTION FROM GROSS TOTAL INCOME

10.1	DEDUCTION IN RESPECT OF CERTAIN INCOMES NOT TO BE ALLOWED UNLESS RETURN IS FILED BY THE DUE DATE

Section:- 80AC Substituted by Finance Act, 2018 w.e.f. A.Y. 2018-19 (*Retrospective*)

Where in computing the total income of an assessee of any previous year relevant to the assessment year commencing on or after—

- (i) the 1st day of April, 2006 but before the 1st day of April, 2018, any deduction is admissible under section 80-IA or section 80-IAB, Section 80-IB or Section 80-IC or Section 80-ID or section 80-IE;
- (ii) the 1st day of April, 2018, any deduction is admissible under any provision of this Chapter under the heading "C.—Deductions in respect of certain incomes",

no such deduction shall be allowed to him unless he furnishes a return of his income for such assessment year on or before the due date specified under sub-section (1) of section 139.

10.2	DEDUCTION IN RESPECT OF MEDICAL INSURANCE PREMIA

Section:- 80D modified - effective from A.Y. 2019-20

(1) Eligible assessee:- Individual or Hindu undivided family

(2) Conditions –

- (a) Mediclaim insurance is paid by the individual or HUF. In the case of individual, payment can also be made to the Central Government Health Scheme or such other scheme as may be notified by the Central Government in this behalf and/or on account of preventive health check-up.
- (b) It is paid out of income chargeable to tax.
- (c) Payment shall be made by any mode other than cash. However, payment on account of preventive health check-up can be made by any mode including cash.

(3) Maximum Deductible Amount:- The maximum deductible amount and other relevant points are given below-

	Individual		HUF
	Family	Parents	
• For whose benefits payment can be made	For the benefit of the assessee, spouse of the assessee and dependent children of the assessee	For the benefit of the parents of the assessee whether dependent or not	For the benefit of any member of family
(A) Nature of payment			
a. Medi-claim insurance premium	Deduction available	Deduction available	Deduction available
b. Contribution made to Central Government Health Scheme or such other scheme as may be notified by the Central Government in this behalf	Deduction available	-	-
c. Payment made on account of preventive health check-up	Deduction available	Deduction available	-
Maximum amount of deduction			
- General deduction [applicable in respect of (a), (b) and (c) given above]	Rs.25,000	Rs.25,000	Rs.25,000

but payment on account of preventive health check-up of self, spouse, dependent children and parents cannot exceed Rs.5,000]			
- Additional deduction (applicable only in the case of medi-claim insurance premium when policy is taken on the life of a senior citizen) ➤ For A.Y. 2016-17 to 2018-19 ➤ For A.Y. 2019-20	Rs.5,000 Rs.25,000	Rs.5,000 Rs.25,000	Rs.5,000 Rs.25,000
(B) Medical Expenditure on the health of a person who is a senior citizen if mediclaim insurance is not paid on the health of such person	Deduction available	Deduction available	Deduction available
- Maximum deduction in respect of (B) ➤ For A.Y. 2016-17 to 2018-19 ➤ For A.Y. 2019-20	Rs.30,000 Rs.50,000	Rs.30,000 Rs.50,000	Rs.30,000 Rs.50,000
(C) Maximum deduction in respect of (A) and (B) ➤ For A.Y. 2016-17 to 2018-19 ➤ For A.Y. 2019-20	Rs.30,000 Rs.50,000	Rs.30,000 Rs.50,000	Rs.30,000 Rs.50,000

Note: Senior citizen for the aforesaid purpose is a resident individual and whose age at any time during the relevant previous years should be at least 60 years.

Practical 1

Mr. Agam, resident individual, aged 39 years, paid medical insurance premium of

(a) Rs. 18,000 to insure his health as well as the health of his spouse.

(b) Rs. 48,000 to insure the health of his father, being resident, aged 63 years, who is not dependent on him.

He also contributed Rs. 5,600 to Central Government Health Scheme during the year.

He has incurred Rs. 5,200 in cash on preventive health check-up of himself and his spouse and Rs. 4,200 by cheque on preventive health check-up of his father.

Compute the deduction allowable under section 80D.

Practical 2

Mr. Shrenik, aged 44 years, paid medical insurance premium of

(a) Rs. 24,000 to insure his health as well as the health of his spouse and dependent children.

(b) Rs. 31,000 during the year to insure the health of his mother, aged 67 years, who is not dependent on him.

He also contributed Rs. 8,000 to Central Government Health Scheme during the year.

He also incurred medical expenditure of Rs. 29,000 on his father, aged 71 years, who is not covered under mediclaim policy. His father is also not dependent upon him.

Compute the deduction allowable under section 80D.

10.3 DEDUCTION IN RESPECT OF MEDICAL TREATMENT, ETC.

Section:- 80DDB modified - effective from A.Y. 2019-20

(1) Eligible assessee: - Resident Individual or Resident Hindu undivided family

(2) Conditions –

1. The assessee has actually paid any amount for the medical treatment of a specified disease or ailment as prescribed by the Board under rule 11DD.
2. If the assessee is an Individual, the expenditure is actually incurred for his medical treatment or wholly/mainly dependent spouse, children, parents, brothers and sisters of such individual.
3. If assessee is a Hindu undivided family, the expenditure is actually incurred for the medical treatment of any member of the family who is wholly/mainly dependent upon the family.
4. The assessee is required to obtain a prescription from a specialist doctor for the purpose of availing this deduction.

(3) Amount of deduction - If all the aforesaid conditions are satisfied, the amount of deduction is Rs. 40,000 or the expenditure actually incurred, whichever is lower.

(a) Where the expenditure incurred is in respect of the assessee or his dependent or any member of a Hindu undivided family of the assessee and who is a senior citizen, then Rs. 60,000 [**Rs.1,00,000 as substituted by Finance Act, 2018 w.e.f. A.Y.2019-20**] or actual expenditure, whichever is lower, shall be the amount of deduction.

(b) Deduction under this section shall be reduced by the amount received, if any, under an insurance from an insurer, or reimbursed by an employer, for the medical treatment of the person referred to above.

(4) Senior citizen for the aforesaid purpose is a resident individual and whose age at any time during the relevant previous years should be at least 60 years.

Practical 3

Mr. Jagrut (45 years) is a resident individual. During the previous year, he incurs Rs. 1,08,000 on medical treatment of his dependent father (67 years) for specified disease. The insurance company reimbursed Rs. 25,000 while employer of Mr. Jagrut reimbursed Rs. 10,000 for such medical treatment of his father. Find out deduction under section 80 DDB under following alternatives:

- (i) Father of Mr. Jagrut is resident
- (ii) Father of Mr. Jagrut is non-resident

What would have been your answer if Mr. Jagrut is a non-resident?

10.4 | SPECIAL PROVISIONS IN RESPECT OF SPECIFIED BUSINESS (START-UP)

Section:- 80-IAC – Effective from A.Y.2018-19 (*Retrospective*)

(1) Eligible Business

~~"eligible business" means a business which involves innovation, development, deployment or commercialisation of new products, processes or services driven by technology or intellectual property;~~

Eligible business means a business carried out by an eligible start-up engaged in innovation, development or improvement of products or processes or services or a scalable business model with a high potential of employment generation or wealth creation. [substituted by Finance Act, 2018, w.r.e.f A.Y.2018-19]

(2) Conditions to be fulfilled for an eligible start-up

1. The assessee is a company or a limited liability partnership (LLP) and engaged in an eligible business.
2. The above company or LLP is incorporated after March 31, 2016 but before ~~April 1, 2019~~ **April 1, 2021** [**Amended by Finance Act, 2018 w.r.e.f. A.Y.2018-19**].
3. The total turnover of the company or LLP does not exceed Rs.25 crore ~~in any of the previous years beginning from P.Y.2016-17 and ending with P.Y.2020-21~~ in the previous year relevant to the assessment year for which deduction under sub-section (1) is claimed [**Amended by Finance Act, 2018 w.r.e.f. A.Y.2018-19**]

4. It holds a certificate of eligible business from the Inter-Ministerial Board of certification as notified in the Official Gazette by the Central Government.
5. The above company or LLP is not formed by splitting up or reconstruction of a business already in existence.

Exception: This condition shall not apply in respect of an undertaking which is formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such undertaking as is referred to in section 33B, in the circumstances and within the period specified in that section;

6. Further, undertaking should not be set up by the transfer of old plant and machinery. However, following two cases old machinery is permitted:

Case 1:- If the value of the old assets does not exceed 20 per cent of the total value of the plant and machinery, this condition is deemed to have been satisfied.

Case2:- Second-hand imported machinery is treated as new subject to satisfaction of few conditions in this regard.

7. The other provisions with reference to furnishing of audit report, determination of quantum of deduction, power of assessing officer to re-compute profit in case of inter-unit transfer, restriction on double deduction, transactions between close connection activities of 80 IA are equally applicable to this section.

(3) Quantum of deduction

If the above conditions are satisfied, 100 per cent of the profits and gains derived from eligible business is deductible for 3 consecutive assessment years. However, this deduction may, at the option of the assessee, be claimed by it for any 3 consecutive assessment years out of 5 years (7 years with effect from A.Y. 2018-19, Amendment by Finance Act, 2017) beginning from the year in which the eligible start-up is incorporated.

Practical 4

ABC Ltd. was incorporated on 1.4.2018 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.

Its estimated turnover and profits and gains from such business for the P.Y.2018-19 to P.Y.2024-25 are as follows:

	(Rs. in crores)						
	P.Y. 2018-19	P.Y. 2019-20	P.Y. 2020-21	P.Y. 2021-22	P.Y. 2022-23	P.Y. 2023-24	P.Y. 2024-25
Total turnover	15	18	20	21	22	23	24
Profits/ Losses	(2.50)	(1.30)	6.80	8.40	9.80	1.60	11.20

Is ABC Ltd. eligible for any tax advantage under the Income-tax Act, 1961? If yes, then suggest best course of action to ABC Ltd. for maximization of such benefits?

10.5 DEDUCTION IN RESPECT OF EMPLOYMENT OF NEW WORKMEN

Section:- 80JJAA modified - effective from A.Y. 2019-20

(1) Eligible Assessee and Amount of deduction

Where the gross total income of an assessee to whom section 44AB applies, includes any profits and gains derived from business, there shall, be allowed a deduction of an amount equal to thirty per cent of additional employee cost incurred in the course of such business in the previous year, for three assessment years including the assessment year relevant to the previous year in which such employment is provided.

(2) Conditions

- (a)** The business is not formed by splitting up, or the reconstruction, of an existing business:
However, this condition is not applicable in respect of a business which is formed as a result of re-establishment, reconstruction or revival by the assessee of the business in the circumstances and within the period specified in section 33B;
- (b)** The business is not acquired by the assessee by way of transfer from any other person or as a result of any business reorganisation;
- (c)** The assessee furnishes alongwith the return of income the report of the accountant, as defined in the Explanation to section 288 giving such particulars in the report as may be prescribed.

(3) Other Points

(a) Explanation.—For the purposes of this section,—

- (i)** "additional employee cost" means total emoluments paid or payable to additional employees employed during the previous year.
 - However, in the case of an existing business, the additional employee cost shall be nil, if—
 - (a) there is no increase in the number of employees from the total number of employees employed as on the last day of the preceding year;
 - (b) emoluments are paid otherwise than by an account payee cheque or account payee bank draft or by use of electronic clearing system through a bank account;
 - For the first year of a new business, emoluments paid or payable to employees employed during that previous year shall be deemed to be the additional employee cost;
- (ii)** "additional employee" means an employee who has been employed during the previous year and whose employment has the effect of increasing the total number of employees employed by the employer as on the last day of the preceding year.
 - However, additional employee does not include,—
 - (a) an employee whose total emoluments are more than twenty-five thousand rupees per month; or
 - (b) an employee for whom the entire contribution is paid by the Government under the Employees' Pension Scheme notified in accordance with the provisions of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952; or
 - (c) an employee employed for a period of less than 240 days during the previous year; or (150 days if assessee is engaged in the business of manufacturing of apparel and **footwear or leather products [As inserted by Finance Act, 2018 w.e.f.A.Y.2019-20]**
 - (d) an employee who does not participate in the recognised provident fund;

Provided further that where an employee is employed during the previous year for a period of less than two hundred and forty days or one hundred and fifty days, as the case may be, but is employed for a period of two hundred and forty days or one hundred and fifty days, as the case may be, in the immediately succeeding year, he shall be deemed to have been employed in the succeeding year and the provisions of this section shall apply accordingly [Inserted by Finance Act, 2018-A.Y. 2019-20].
- (iii)** "emoluments" means any sum paid or payable to an employee in lieu of his employment by whatever name called, but does not include—
 - (a) any contribution paid or payable by the employer to any pension fund or provident fund or any other fund for the benefit of the employee under any law for the time being in force; and

- (b) any lump-sum payment paid or payable to an employee at the time of termination of his service or superannuation or voluntary retirement, such as gratuity, severance pay, leave encashment, voluntary retrenchment benefits, commutation of pension and the like.
- (b) No deduction under this section shall be allowed if it has not been claimed in the return of income.
- (c) Double deduction is not possible in respect of the same business income under section 80H to 80RRB.
- (d) The aggregate deductions under the various provisions referred to above, shall not exceed the profits and gains of the undertaking or unit or enterprise or eligible business, as the case may be.

Practical 5

Arjun Ltd. commenced the chain of medical stores on **1.4.2018**. It employed 200 employees during the **P.Y.2018-19**, the details of whom are as follows:

Sr. No.	No. of employees	Date of employment	Whether they participate in RPF?	Total monthly emoluments per employee (Rs.)
(i)	25	1.4.2018	Yes	20,000
(ii)	75	1.5.2018	Yes	30,000
(iii)	50	1.8.2018	No	17,000
(iv)	50	1.9.2018	Yes	22,000

Compute the deduction available to Arjun Ltd. under section 80JJAA for **A.Y.2019-20**, assuming that its total turnover is 20.21 crores and all the salary payments were made by an account payee cheques.

All the 50 employees joined on 1.9.2018 continue to be employed for the financial year **2019-20**.

10.6 DEDUCTION IN RESPECT OF CERTAIN INCOME OF PRODUCER COMPANIES

Section:- 80PA –Effective from A.Y.2019-20

[Inserted by Finance Act, 2018 w.e.f. A.Y. 2019-20]

(1) **Eligible assessee:** Assessee being Producer company u/s 581A(I) of the Companies Act, 1956.

(2) **Conditions:-**

- (a) The total turnover of the producer company is less than Rs.100 crore in any previous year.
- (b) The gross total income of the producer company includes any profits and gains derived from “eligible business”.

(3) **Amount of deduction :**

100% of the profit and gain attributable to “eligible business” is deductible for the assessment years 2019-20 to 2024-25. If the assessee is also entitled to deduction under any other provision or provision of Chapter VI-A (i.e., sections 80C to 80U), the deduction under section 80PA shall be allowed from the gross total income as reduced by the deductions under such other provisions.

(4) **Other points to be kept in mind:**

(1) **Eligible business means**

- (a) the marketing of agricultural produce grown by the members; or
- (b) the purchase of agricultural implements, seeds, livestock or other articles intended for agriculture for the purpose of supplying them to the members; or
- (c) the processing of the agricultural produce of the members;

(2) "member" shall have the meaning assigned to it in clause (d) of section 581A of the Companies Act, 1956 (1 of 1956);

10.7 DEDUCTION IN RESPECT OF INTEREST ON DEPOSITS IN SAVINGS ACCOUNT**Section:- 80TTA – Effective from A.Y. 2019-20**

- (1) **Eligible assessee:** Individual or Hindu Undivided Family
- (2) **Amount of deduction :** Upto Rs. 10,000 in aggregate in respect of any income by way of interest on deposits (not being time deposits) in a savings account with —
- (a) a banking company;
 - (b) a co-operative society engaged in carrying on the business of banking (including a co-operative land mortgage bank or a co-operative land development bank); or
 - (c) a post office.
- (3) **Other points to be kept in mind:**
- (a) The deduction under this section is not available in respect of interest on time deposits
 - (b) Under section 10(15) (i), post office savings bank interest is exempt up to Rs. 3,500 (in an individual account) and Rs. 7,000 (in a joint account).
 - (c) **A senior citizen (who can avail of deduction u/s 80TTB) shall not eligible for the deduction under section 80TTA. [Inserted by Finance Act, 2018 w.e.f. A.Y.2019-20]**

10.8 DEDUCTION IN RESPECT OF INTEREST ON DEPOSITS IN CASE OF SENIOR CITIZENS**Section:- 80TTB – Effective from A.Y.2019-20****[Inserted by Finance Act, 2018 w.e.f. A.Y.2019-20]**

- (1) **Eligible assessee:** Assessee being a senior citizen
- (2) **Amount of deduction :** Upto Rs. 50,000 in aggregate in respect of any income by way of interest on deposits with —
- (a) a banking company;
 - (b) a co-operative bank; or
 - (c) a post office (it may be interest on fixed deposits, interest on savings account or any other interest).
- (3) **Other points to be kept in mind:**
- Where the aforesaid income is derived from any deposits in an account held by, or on behalf of a firm, an association of persons, or a body of Individuals, no deduction shall be allowed in respect of such income in computing the total income of any partner of the firm or any member of the association or body.

Practical 6

Taxpayer provides following information about interest income earned by him during the previous year:

- (i) Interest on saving account with State Bank of India : Rs. 8,000
- (ii) Interest on saving account with Post Office: Rs. 4,000
- (iii) Interest on saving account with Co-operative Land Mortgage Bank: Rs. 500
- (iv) Interest on fixed deposits with State Bank of India: Rs. 49,000

Find out deduction under relevant section under following alternatives:

- (a) Taxpayer is a resident individual aged 44 years
- (b) Taxpayer is a resident individual aged 66 years

11 – COMPUTATION OF TOTAL INCOME AND TAX LIABILITY**11.1 TAX ON LONG TERM CAPITAL GAIN****Section:- 112**

Long Term Capital Gain shall be taxed at 20% under section 112.

- (1) However, if other incomes are less than exemption limit, then to that extent long term capital gain shall be shifted to other incomes and remaining long term capital gain shall be taxed at 20%. **[This is called Shifting Benefit].**
- (2) Shifting benefit is not available to non-resident.
- (3) **In following cases option is available to tax long term capital gain at 10% instead of 20%**
 - (a) Listed shares
 - (b) Listed securities
 - (c) Zero coupon bond (whether listed or not)

Option I- Compute capital gain as per general rules and tax the same @20%

Option II- Compute capital gain without indexation and tax the same @10%

11.2 TAX ON LONG-TERM CAPITAL GAINS IN CERTAIN CASES**Section:- 112A – Effective from A.Y. 2019-20**

[Inserted by Finance Act, 2018 w.e.f A.Y.2019-20]

(1) Sub-section 112A(1) :- Overriding Effect and Conditions for applicability of this section

This section has an overriding effect over the provisions of section 112.

Cumulative conditions for applicability of Section 112 A

- (i) the total income of an assessee includes any income chargeable under the head "Capital gains";
- (ii) the capital gains arise from the transfer of a long-term capital asset being an equity share in a company or a unit of an equity oriented fund or a unit of a business trust;
- (iii) securities transaction tax under Chapter VII of the Finance (No. 2) Act, 2004 has,—
 - (a) in a case where the long-term capital asset is in the nature of an equity share in a company, been paid on acquisition and transfer of such capital asset; or
 - (b) in a case where the long-term capital asset is in the nature of a unit of an equity oriented fund or a unit of a business trust, been paid on transfer of such capital asset.

Remarks:

1. The condition specified in clause (iii) shall not apply to a transfer undertaken on a recognised stock exchange located in any International Financial Services Centre and where the consideration for such transfer is received or receivable in foreign currency. **[Section 112A(3)]**
2. The Central Government may, by notification in the Official Gazette, specify the nature of acquisition in respect of which the Condition no. (iii) (a) shall not apply. **[Section 112A(4)]:-** Refer Notification No.60/2018 given below.

(2) Sub-section 112A(2):-Tax Rate applicable on such long-term capital gain

Section 112A(2) prescribes that the tax shall be calculated on such long-term capital gains exceeding Rs. one lakh rupees at the rate of 10%.

It also provides that shifting benefit is available to an individual or Hindu Undivided Family, being a resident, in the event of other income falls short of the maximum amount not chargeable to tax.

(3) Section 112 A(5):- Non-availability of deductions under Chapter VI-A

Where the gross total income of an assessee includes any long-term capital gains chargeable to tax under section 112 A, the deduction under Chapter VI-A shall not be allowed from such long-term capital gains.

(4) Section 112 A(6):- Non-availability of rebate under section 87 A

Where the total income of an assessee includes any long-term capital gains chargeable to tax under section 112 A, the rebate under section 87A shall not be allowed from the income-tax on such long-term capital gains.

Explanation.—For the purposes of this section,—

(a) "equity oriented fund" means a fund set up under a scheme of a mutual fund specified under clause (23D) of section 10 and,—

(i) in a case where the fund invests in the units of another fund which is traded on a recognised stock exchange,—

(A) a minimum of ninety per cent of the total proceeds of such fund is invested in the units of such other fund; and

(B) such other fund also invests a minimum of ninety per cent of its total proceeds in the equity shares of domestic companies listed on a recognised stock exchange; and

(ii) in any other case, a minimum of sixty-five per cent of the total proceeds of such fund is invested in the equity shares of domestic companies listed on a recognised stock exchange:

Provided that the percentage of equity shareholding or unit held in respect of the fund, as the case may be, shall be computed with reference to the annual average of the monthly averages of the opening and closing figures;

(b) "International Financial Services Centre" shall have the meaning assigned to it in clause (q) of section 2 of the Special Economic Zones Act, 2005 (28 of 2005);

(c) "recognised stock exchange" shall have the meaning assigned to it in clause (ii) of Explanation 1 to clause (5) of section 43.

‡ **Notification No. 60/2018, dated 01-10-2018** ‡

As on 01/10/2018 Government issued a notification no. 60/2018. In preamble of said notification, the Government notifies all transactions (with few specific exclusion and few specific inclusion) of acquisition of equity share entered into on or after the 1st day of October, 2004 which are not chargeable to STT EXCEPT the **Column 1** transactions but including the **column 2** transactions;

Column 1	Column 2
Specific exclusion – STT on acquisition not paid, not eligible for concessional tax rate under section 112A	Specific Inclusion – STT on acquisition not paid, still eligible for concessional tax rate under section 112A
Acquisition of existing listed equity share in a company whose equity shares are not frequently traded in a recognised stock exchange of India is made through a preferential issue	Acquisition of listed equity shares in a company which has been approved by the Supreme Court, High Court, National Company Law Tribunal, Securities and Exchange Board of India or Reserve Bank of India in this behalf
	Acquisition of listed equity shares in a company by any non-resident in accordance with foreign direct investment guidelines issued by the Government of India

	Acquisition of listed equity shares in a company by an investment fund referred to in clause (a) of Explanation 1 to section 115UB of the Act or a venture capital fund referred to in clause (23FB) of section 10 of the Act or a Qualified Institutional Buyer Acquisition of listed equity shares in a company through preferential issue to which the provisions of chapter VII of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 does not apply
Where transaction for acquisition of existing listed equity share in a company is not entered through a recognised stock exchange of India	Following acquisition of listed equity shares in a company made in accordance with the provisions of the Securities Contracts (Regulation) Act, 1956 - acquisition through an issue of share by a company other than the issue referred to in clause (a) i.e. preferential allotment. - acquisition by scheduled banks, reconstruction or securitisation companies or public financial institutions during their ordinary course of business - acquisition which has been approved by the Supreme Court, High Courts, National Company Law Tribunal, Securities and Exchange Board of India or Reserve Bank of India in this behalf - acquisition under employee stock option scheme or employee stock purchase scheme framed under the Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999 - acquisition by any non-resident in accordance with foreign direct investment guidelines of the Government of India - where acquisition of shares of company is made under Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulation, 2011 - acquisition from the Government - acquisition by an investment fund referred to in clause (a) to Explanation 1 to section 115UB of the Income-tax Act or a venture capital fund referred to in clause (23FB) of section 10 of the income-tax Act or a Qualified Institutional Buyer - acquisition by mode of transfer referred to in sections 47 or 50B of the Income-tax Act, if the previous owner of such shares has not acquired them by any mode referred to in clause (a) or clause (b) or clause (c) [other than the transactions referred to in the proviso to clause (a) or clause (b)].
Acquisition of equity share of a company during the period beginning from the date on which the company is delisted from a recognised stock exchange and ending on the date immediately preceding the date on which the company is again listed on a	-

recognised stock exchange in accordance with the Securities Contracts (Regulation) Act, 1956 read with Securities and Exchange Board of India Act, 1992 (15 of 1992) and the rules made thereunder	
Explanation,—For the purposes of this notification,— (a) “frequently traded shares” means shares of a company, in which the traded turnover on a recognised stock exchange during the twelve calendar months preceding the calendar month in which the acquisition and transfer is made, is at least ten per cent. of the total number of shares of such class of the company: Provided that where the share capital of a particular class of shares of the company is not identical throughout such period, the weighted average number of total shares of such class of the company shall represent the total number of shares. (b) “listed” means listed in a recognised stock exchange in India in accordance with the Securities Contracts (Regulation) Act, 1956 and the rules made thereunder (c) “preferential issue” and “Qualified Institutional Buyer” shall have the meanings respectively assigned to them in sub-regulation (1) of regulation (2) of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009. (d) “public financial institution” and “scheduled bank” shall have the meanings respectively assigned to them in Explanation to clause(viia) of sub-section (1) of section 36 of Income-tax Act. (e) “recognised stock exchange” shall have the same meaning assigned to it in clause (f) of section 2 of the Securities Contracts (Regulation) Act, 1956 (f) “reconstruction company” and “securitisation company” shall have the meanings respectively assigned to them in sub-section (1) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.	

11.3 | MODE OF COMPUTATION OF CAPITAL GAIN FOR AN ASSET REFERRED TO IN SECTION 112A (1)

Section:- 48 – Effective from A.Y. 2019-20

Third proviso to Section 48 has been inserted to provide that while determining capital gain for an asset referred to in section 112A(1),

- (c) Benefit of Indexation (second proviso to section 48) shall not be available
- (d) In case of non-resident, benefit of conversion rule (first proviso to section 48) shall not be available.

11.4 | MANNER OF DETERMINATION OF COST OF ACQUISITION FOR COMPUTING CAPITAL GAIN FOR AN ASSET REFERRED TO IN SECTION 112A (1)

Section:- 55(2)(ac) – Effective from A.Y. 2019-20

[Inserted by Finance Act, 2018 w.e.f. A.Y.2019-20]

The cost of acquisition for the purposes of computing capital gains referred to in section 112A(1) in respect of the long-term capital asset acquired by the assessee before the 1st day of February, 2018, shall be deemed to be the higher of—

- (i) the actual cost of acquisition of such asset;
- (ii) the lower of—

- a. the fair market value of such asset;
- b. the full value of consideration received or accruing as a result of the transfer of the capital asset.

Meaning of "fair market value"

- (i) in a case where the capital asset is listed on any recognised stock exchange as on the 31st day of January, 2018, the highest price of the capital asset quoted on such exchange on the said date:
Provided that where there is no trading in such asset on such exchange on the 31st day of January, 2018, the highest price of such asset on such exchange on a date immediately preceding the 31st day of January, 2018 when such asset was traded on such exchange shall be the fair market value;
- (ii) in a case where the capital asset is a unit which is not listed on a recognised stock exchange as on the 31st day of January, 2018, the net asset value of such unit as on the said date;
- (iii) in a case where the capital asset is an equity share in a company which is—
 - (A) not listed on a recognised stock exchange as on the 31st day of January, 2018 but listed on such exchange on the date of transfer;
 - (B) listed on a recognised stock exchange on the date of transfer and which became the property of the assessee in consideration of share which is not listed on such exchange as on the 31st day of January, 2018 by way of transaction not regarded as transfer under section 47,
 an amount which bears to the cost of acquisition the same proportion as Cost Inflation Index for the financial year 2017-18 bears to the Cost Inflation Index for the first year in which the asset was held by the assessee or for the year beginning on the first day of April, 2001, whichever is later.

Practical 2

From the following information, compute capital gain for the purpose of section 112A

Particulars	Rs. in lakhs
Actual cost of acquisition	100
Fair market value as on 31-01-2018	200
Sale Consideration	250

Practical 3

From the following information, compute capital gain for the purpose of section 112A

Particulars	Rs. in lakhs
Actual cost of acquisition	100
Fair market value as on 31-01-2018	200
Sale Consideration	150

Practical 4

From the following information, compute capital gain for the purpose of section 112A

Particulars	Rs. in lakhs
Actual cost of acquisition	100
Fair market value as on 31-01-2018	50
Sale Consideration	150

Practical 5

From the following information, compute capital gain for the purpose of section 112A

Particulars	Rs. in lakhs
Actual cost of acquisition	100
Fair market value as on 31-01-2018	200
Sale Consideration	50

Practical 6

Mr. Mohan (35 years), resident provides the following information. Calculate his tax liability

Particulars	Rs.
Income under the head house property	3,00,000
Business Income	7,50,000
Long term capital gain u/s 112A	2,00,000
Contribution to Public Provident Fund	1,50,000

Practical 7

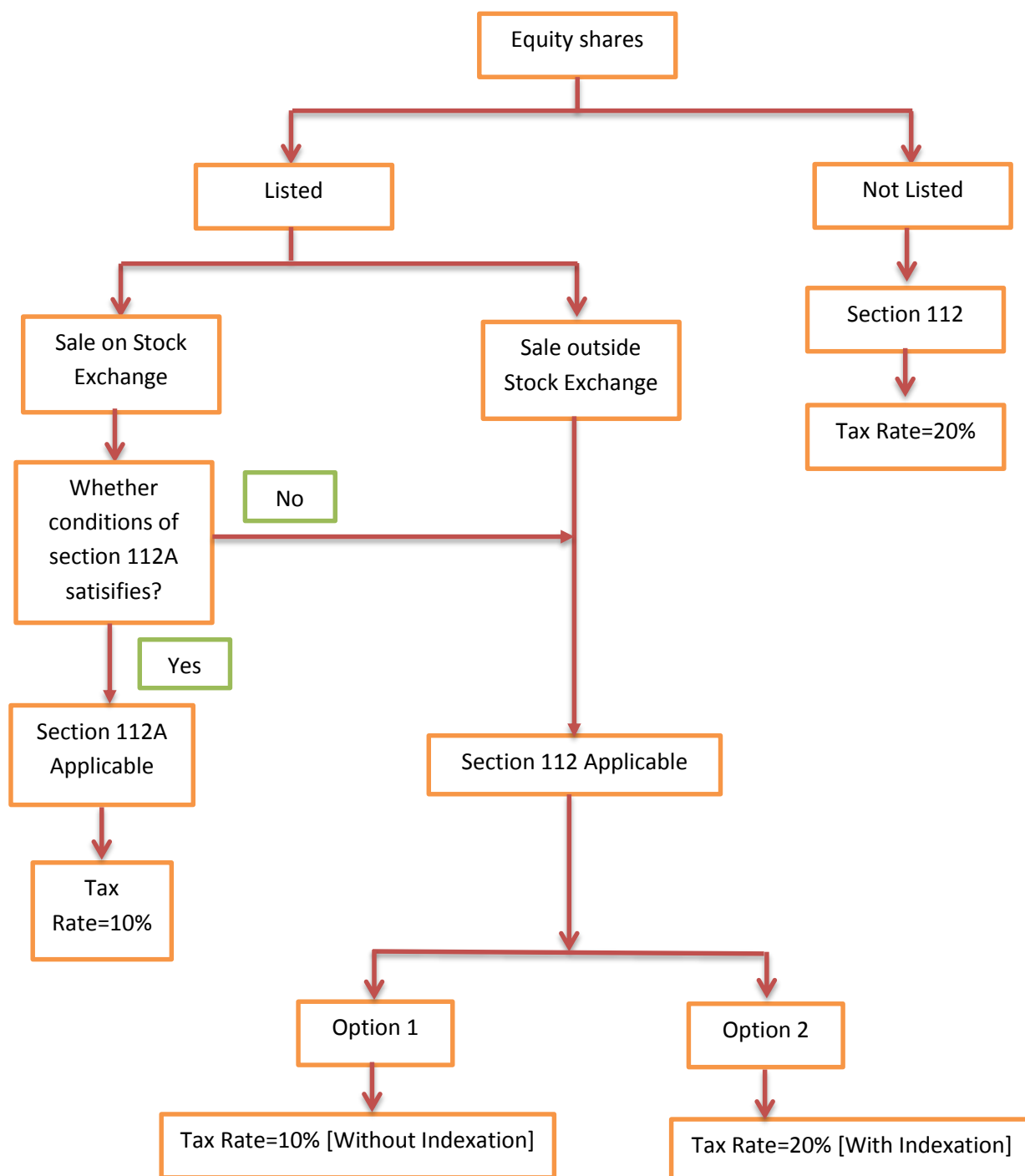
Mr. Mohan (25 years), resident provides the following information. Calculate his tax liability

Particulars	Rs.
Income under the head house property	3,60,000
Long term capital gain u/s 112A	20,000
Contribution to Public Provident Fund	30,000

Practical 8

Mr. Mohan (55 years), resident provides the following information. Calculate his tax liability.

Particulars	Rs.
Business Income	1,30,000
Long term capital gain u/s 112A	5,00,000
Contribution to Public Provident Fund	30,000

Taxability of Long Term Capital Gain on Sale of Equity Shares at a Glance
11.5 TAX ON INCOME REFERRED TO IN SECTION 68 OR SECTION 69 OR SECTION 69A OR SECTION 69B OR SECTION 69C OR SECTION 69D.

Section:- 115BBE Modified by FA 2018 -Effective from A.Y. 2017-18 (Retrospective)

(1) Where the total income of an assessee,—

- (a) includes any income referred to in section 68, section 69, section 69A, section 69B, section 69C or section 69D and reflected in the return of income furnished under section 139; or
 - (b) determined by the Assessing Officer includes any income referred to in section 68, section 69, section 69A, section 69B, section 69C or section 69D, if such income is not covered under clause (a),
- the income-tax payable shall be the aggregate of—

- (i) the amount of income-tax calculated on the income referred to in clause (a) and clause (b), at the rate of sixty per cent; and
- (ii) the amount of income-tax with which the assessee would have been chargeable had his total income been reduced by the amount of income referred to in clause (i).
- (2) Notwithstanding anything contained in this Act, no deduction in respect of any expenditure or allowance or set off of any loss shall be allowed to the assessee under any provision of this Act in computing his income referred to in clause (a) **[and clause (b)]** of sub-section (1).

Practical 9

Mr. X filed return for the **A.Y. 2019-20** declaring non-speculative business loss of Rs.55,50,000. However, the assessing officer made an addition of Rs. 6,00,000 on account of unexplained cash credit under section 68 of the Act. Mr. X denies tax liability on the ground that he is entitled for set-off of loss against the addition made by assessing officer. Whether claim made by Mr. X is correct? Also find out tax payable by Mr. X, if any.

11.6 RATES OF DISTRIBUTION TAX AND MEANING OF 'EQUITY ORIENTED FUND' MODIFIED

Sections:- 115 R and 115 T Modified by Finance Act, 2018-Effective from 1st April, 2018

Section	Particulars	Rate of Tax
115R	Tax on distributed income of UTI/Mutual Funds	
	— Distribution to a unit-holder of equity-oriented funds	10%
	— Distribution by Money Market Mutual Fund or a Liquid Fund or any Other Fund to Unit Holder being individuals/ HUFs	25%
	— Distribution by Money Market Mutual Fund or a Liquid Fund or any Other Fund to Unit Holder being any other person	30%
	— Distribution by infrastructure debt funds to non-residents/foreign companies	5%

Surcharge@12% would be leviable on distribution tax levied under sections 115-O, 115-QA and 115R **irrespective of amount distributed**. Further, Health & Education cess@4% leviable on (the distribution tax plus surcharge).

Explanation (b) to Section 115T defined "Equity oriented fund" as under:

"Equity oriented fund" means a fund set up under a scheme of a mutual fund specified under clause (23D) of section 10 and,—

- (i) in a case where the fund invests in the units of another fund which is traded on a recognised stock exchange,—
- (A) a minimum of ninety per cent of the total proceeds of such fund is invested in the units of such other fund; and
- (B) such other fund also invests a minimum of ninety per cent of its total proceeds in the equity shares of domestic companies listed on a recognised stock exchange; and
- (ii) in any other case, a minimum of sixty-five per cent of the total proceeds of such fund is invested in the equity shares of domestic companies listed on a recognised stock exchange:

Provided that the percentage of equity shareholding or unit held in respect of the fund, as the case may be, shall be computed with reference to the annual average of the monthly averages of the opening and closing figures.

12 - ASSESSMENT OF FIRMS / LLP

12.1 DEDUCTION OF INTEREST PAID TO PARTNERS

Section:- 40(b)

In order to claim deduction of interest paid to partners, the firm shall fulfill following conditions:

- Payment of interest to any partner is authorised by the partnership deed and it shall be in accordance with the terms of such deed.
- Payment of interest pertains to the period on or after the date of partnership deed.
- The amount of interest shall not exceed amount calculated at the rate of 12 % simple interest p.a.

When recipient of interest acts in a representative capacity

Explanations 1 and 2 to section 40(b) deal with cases where recipient of interest acts in a representative capacity.

Explanation 1 provides that where an individual is a partner in a firm on behalf, or for the benefit, of any other person, (to be called partner in a representative capacity) interest paid by the firm to such individual, otherwise than as partner in a representative capacity, is not taken into account, for the purposes of section 40(b).

Explanation 2 provides that where an individual is a partner in a firm, otherwise than in a representative capacity, interest paid by the firm to such individual will not be taken into account for the purposes of section 40(b), if such interest is received by him, on behalf, or for the benefit, of any other person.

Practical 1

X and Y are equal partners of ABC & Co. On 1st day of previous year, Mr. X contributed capital of Rs.10,00,000 @ 15% p.a. On the same day, Mr. X had given a loan of Rs. 25,00,000 to the firm @18% p.a. While Mr. Y contributed capital of Rs. 5,00,000 @ 15% p.a.

Discuss tax consequences in the hands of firm as well as partners.

Solution**Tax consequences in the hands of Firm**

- While computing income under the head "PGBP", firm will get deduction of interest paid to partners as under :

Nature of contribution	Ceiling under section 40(b)	Deductible interest
Partners' Capital		
- Mr. X	12% of Rs.10,00,000	Rs. 1,20,000
- Mr. Y	12% of Rs. 5,00,000	Rs. 60,000
Partner's Loan (given by Mr. X)	12% of Rs. 25,00,000	Rs. 3,00,000

- Firm is not required to deduct TDS on interest paid to partner in view of provisions contained in section 194A(3)(iv).

Tax consequences in the hands of partners

Name of the partner	Taxable amount of interest under the head "PGBP"
Mr. X	
- Capital contribution	Rs. 1,20,000
- Loan Contribution	Rs. 3,00,000
Mr. Y	Rs. 60,000

Readers Note:

Practical 2

What would have been the tax consequences in the hands of firm if loan is given by X-HUF instead of Mr. X?

Solution

Tax consequences in the hands of Firm if loan is given by X-HUF

In view of explanation 2 to section 40(b), restriction contained in this section cannot be applied if loan is given by X-HUF. Therefore, the partnership firm can claim deduction of entire interest paid to the X-HUF. However, such claim of interest is subject to the conditions mentioned in:

- (a) Section 36(1) (iii);
- (b) Section 40 (a) (ia);
- (c) Section 40 A(2) and
- (d) Section 40 A(3).

As per the requirements of section 194A, partnership firm is required to deduct tax at source in respect of interest paid or payable to X-HUF.

Readers Note:

Practical 3

Firm paid interest on partners' capital account as well on current accounts at the rate of 12%. However, interest on current account transaction was not authorized by partnership deed. Can firm claim deduction of interest on current account transactions?

Solution

Kerala High Court in case of **Novel Distributing Enterprises vs. DCIT & ANR. 251 ITR 704** held that partnership deed did not authorize payment of interest on current accounts of the partners, therefore, same cannot be allowed as deduction in view of the provisions of section 40(b) of the Act.

Readers Note:

12.2 DEDUCTION OF REMUNERATION PAID TO PARTNERS

Section:- 40(b), Explanation 1 and 2

In order to claim deduction of salary, bonus, commission or remuneration, by whatever name called paid to partners, the firm shall fulfill following conditions:

- (1) The payment of salary, bonus, commission or remuneration, by whatever name called shall be made to a working partner.

Who is a Working Partner?

As per the Explanation 4 to section 40(b) a "working partner" means:

- a. an individual who is a partner of a firm ; and
- b. such an individual is **actively engaged** in conducting the affairs of the business/profession of the firm.

- (2) Such payment to the working partners is authorised by the partnership deed and it shall be in accordance with the terms of such deed.

Circular No. 739, dated March 25, 1996.

The Board have received representations seeking clarification regarding disallowance of remuneration paid to the working partners as provided under section 40(b)(v). In particular, the representations have referred to two types of clauses which are generally incorporated in the partnership deeds. These are:

- the partners have agreed that the remuneration to a working partner will be the amount of remuneration allowable under the provisions of section 40(b)(v) ; and
- the amount of remuneration to working partner will be as may be mutually agreed upon between partners at the end of the year.

It is clarified by the CBDT that for the assessment years subsequent to the assessment year 1996-97, **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.**

- (3) Such payment to working partner pertains to the period on or after the date of partnership deed.
- (4) The maximum amount of such payment to all the partners during the previous year shall not exceed the aggregate amount computed as under:

Book Profit	Allowable remuneration
(a) On the first Rs. 3,00,000 of the book profit or in case of a loss	Rs. 1,50,000 or 90 per cent of the book profit, whichever is more
(b) On the balance of the book profit	60 per cent of the book profit

Steps for determination of "Book Profit" - Explanation 3 to section 40(b):

Step 1 - Find out the net profit of the firm as per Profit and Loss Account.

Step 2 - Perform adjustments under the head "PGBP" [i.e. sections 28 to 44DB].

Step 3 - Add aggregate amount of remuneration paid or payable to partners if such amount has been debited to the Profit and Loss Account.

The resulting amount is "book profit".

Practical 4

Partnership firm provides following information:

Particulars	Rs.
Net Profit as per P/L after debiting remuneration of Rs.4,50,000	80,000
Disallowance u/s 37(1) and 43B	42,000
Unabsorbed depreciation	5,00,000
Brought forward business loss	4,00,000

Find out deductible remuneration.

Solution

Calculation of Book Profit

Particulars	Rs.
Net Profit as per P/L after debiting remuneration of Rs.4,50,000	80,000
Add: Remuneration debited to P/L account	4,50,000

Add: Disallowance u/s 37(1) and 43B	42,000
Book Profit before adjustment of unabsorbed depreciation	5,72,000
Less: Permissible adjustment of unabsorbed depreciation (Working Note 1)	1,72,000
Book Profit	4,00,000

Working Note 1: Calculation of permissible adjustment of unabsorbed depreciation

Particulars	Rs.
Book Profit before adjustment of unabsorbed depreciation	5,72,000
Less: Brought forward Business Loss	4,00,000
Book Profit available for adjustment of unabsorbed depreciation (A)	1,72,000
Unabsorbed depreciation (given in the practical) (B)	5,00,000
Permissible adjustment of unabsorbed depreciation (A) or (B) whichever is lower	1,72,000

Calculation of deductible remuneration under section 40(b)

Book Profit	Remuneration (Rs.)
- On first book profit of Rs.3,00,000 (a) $3,00,000 \times 90\% = \text{Rs.}2,70,00$ Or (b) Rs.1,50,000 Whichever is higher	2,70,000
- On balance book profit $[\text{Rs.}4,00,000 - \text{Rs.}3,00,000] \times 60\%$	60,000
Maximum permissible remuneration (limit)	3,30,000
Deductible remuneration u/s 40(b) is (a) Amount debited to P/L Account i.e., Rs.4,50,000 Or (b) Rs.3,30,000 (limit as computed above) whichever is lower	3,30,000

Readers Note:**12.3 CARRY FORWARD AND SET OFF OF LOSS IN THE CASE OF CHANGE IN THE CONSTITUTION OF FIRM****Section:- 78 (1)**

Section 78(1) provides that where there is a change in the constitution of the firm on account of death/retirement of a partner, the firm shall not be entitled to set off and carry forward so much of the loss proportionate to the share of such partner.

Remark:

1. This provision is not applicable when there is a change in profit-sharing ratio amongst the partners or in case of admission of a partner.
2. This section is applicable to the losses and not to the unabsorbed allowances. Therefore, entire unabsorbed depreciation can be carried forward by the reconstituted firm.

Practical 5

X, Y, & Z are equal partners of XYZ & Co.

Brought forward business loss was Rs.3,00,000

Mr. X retires in after 6 months from beginning of the previous year. Find out losses which cannot be carried forward by the firm under the following alternatives.

(a) Profit for the period of first 6 months - Rs.60,000.

(b) Loss for the period of first 6 months - Rs.90,000

Solution**Alternative (a)**

Particulars		Rs.
Step 1	Share of Mr. X (retiring partner) in brought forward loss [$\text{Rs.}3,00,000 \times 1/3^{\text{rd}}$]	1,00,000
Step 2:	Share of Mr. X (retiring partner) in current year profit [$\text{Rs.}60,000 \times 1/3^{\text{rd}}$]	(20,000)
Step 3:	Losses not allowed to be carried forward by the firm	80,000

Alternative (b)

Particulars		Rs.
Step 1	Share of Mr. X (retiring partner) in brought forward loss [$\text{Rs.}3,00,000 \times 1/3^{\text{rd}}$]	1,00,000
Step 2:	Share of Mr. X (retiring partner) in current year Loss [$\text{Rs.}90,000 \times 1/3^{\text{rd}}$]	30,000
Step 3:	Losses not allowed to be carried forward by the firm	1,30,000

Readers Note:

12.4 TAXABILITY OF PARTNER'S SHARE WHERE INCOME OF THE FIRM IS EXEMPT UNDER CHAPTER III / DEDUCTIBLE UNDER CHAPTER VI-A

Circular:- 8 /2014

- Section 10(2A) provides that a partner's share in the total income of a firm which is separately assessed as such shall not be included in computing the total income of the partner. In effect, a partner's share of profits in such firm is exempt from tax in his hands.
- An issue has arisen as to the amount which would be exempt in the hands of the partners of a partnership firm, in cases where the firm has claimed exemption/deduction under Chapter III or Chapter VI-A.
- The CBDT has clarified that the income of a firm is to be taxed in the hands of the firm only and the same can under no circumstances be taxed in the hands of its partners. Therefore, the entire profit credited to the partners' accounts in the firm would be exempt from tax in the hands of such partners, even if the income chargeable to tax becomes Nil in the hands of the firm on account of any exemption or deduction available under the provisions of the Act.

Practical 6

During the previous year under consideration, the partnership firm consisting of three equal partners, had earned only income – i.e. dividend from Indian Company amounting to Rs.9,00,000. Such income earned by the firm was totally exempt under section 10(34) of the Act. All the three partners claimed exemption under section

10(2A) in respect of their proportionate share. The assessing officer denied exemption to partners on the ground that firm had not paid tax on Rs. 9,00,000 since such Rs.9,00,000 would not form part of total income of the firm. Whether the action of assessing officer is tenable?

Solution

Considering the last para of the above circular, it has been clarified that the income of a firm is to be taxed in the hands of the firm only and the same can under no circumstances be taxed in the hands of its partners. Therefore, the entire profit credited to the partners' accounts in the firm would be exempt from tax in the hands of such partners, even if the income chargeable to tax becomes Nil in the hands of the firm on account of any exemption under the provisions of the Act.

Therefore, the action of assessing officer taxing such share in the hands of three partners is not tenable.

Readers Note:

13 — ASSESSMENT OF AOP OR BOI**13.1 HOW TO COMPUTE INCOME UNDER THE HEAD “PGBP” IN CASE OF AN AOP/BOI?****Section:- 40(ba)**

- Any salary, bonus, commission or remuneration by whatever name called is paid by the AOP/BOI to its members is not deductible in computing the income under the head “PGBP”.
- Similarly, any interest paid by AOP/BOI to its members by whatever name called is not deductible in computing income under the head “PGBP”.
- Explanation 1 to section 40(ba) —Where interest is paid by an association or body to any member thereof who has also paid interest to the association or body, the amount of interest to be disallowed under this clause shall be limited to the amount by which the payment of interest by the association or body to the member exceeds the payment of interest by the member to the association or body.
- Explanation 2 and 3 to section 40(ba) are similar to explanations 1 and 2 to section 40(b) under chapter “assessment of firms/LLP”.

Practical 1

From the following information, find out interest to be disallowed in the hands of Dagu Magu & Co., AOP (consisting of two members, Mr. Dagu and Mr. Magu) under section 40(ba).

- AOP paid interest to member Mr. Dagu Rs.35,000 while recovered on drawings Rs.4,000.
- AOP paid interest to member Mr. Magu Rs. 8,000 while recovered on drawings Rs. 3,000.

Solution

Name of members	Interest paid to members (A)	Interest recovered from members (B)	Net interest (A-B)
Mr. Dagu	Rs. 35,000	Rs. 4,000	Rs. 31,000
Mr. Magu	Rs. 8,000	Rs. 3,000	Rs. 5,000
Interest to be disallowed in the hands of AOP			Rs.36,000

Readers Note:**Practical 2**

PQRS & Co., an AOP provides following information:

Name of Member	Interest paid to Member	Interest recovered from Member
Mr. P	Rs. 8,000	Nil
Mr. Q	Rs. 10,000	Nil
Mr. R	Rs. 13,000	Nil
Mr. S	Nil	Rs. 21,000

Find out interest to be disallowed under section 40(ba) in the hands of AOP

Solution

Name of member	Interest paid to members (A)	Interest recovered from members (B)	Net interest (A-B)
Mr. P	Rs. 8,000	Rs. Nil	Rs. 8,000
Mr. Q	Rs. 10,000	Rs. Nil	Rs. 10,000
Mr. R	Rs.13,000	Rs. Nil	Rs.13,000
Mr. S	Rs. Nil	Rs. 21,000	Rs. Nil
Interest to be disallowed in the hands of AOP			Rs. 31,000

Readers Note:**13.2 TAX RATE APPLICABLE TO AN AOP/BOI****Section:- 167B, 67A, 86**

At what rate the income of AOP shall be taxed depends on following factors:

- (1) Whether shares of members are known (determinate)/ unknown (indeterminate)?
- (2) Who are the members of AOP?
- (3) What are the other incomes of members?

Considering the above factors, following possibilities may emerge:-

(A) Case 1 :**(a) Tax rate applicable to AOP/BOI under Case 1**

If all the followings conditions are satisfied, then AOP shall be taxed as per the rates applicable to an individual (i.e. Slab rate)

- (1) Shares of members are determinate / known.
- (2) All members of AOP are subject to slab rate.
- (3) None of the member has a total (net) income exceeding exemption limit. (Income from AOP shall not be considered at this stage)

(b) Rules for computation tax liability of members of AOP / BOI under this case.

Once AOP shall be taxed as per slab rates, then Share from AOP (Interest, Remuneration and Profit) shall also be taxed in the hands of members.

(1) How to compute share from AOP? [Section 67A (1)]

Particulars	Member 1	Member 2	Member 3.....	Total
Interest (Net)	xxxx	xxxx	Xxxx	xxxx
Remuneration	xxxx	xxxx	Xxxx	xxxx
Profit / loss	xxxx	xxxx	Xxxx	xxxx (Balancing Figure)
TOTAL				TOTAL INCOME OF AOP

(2) Under which head "Share from AOP" shall be taxed?[Section 67A (2)]

For the purposes of assessment, the share of a member in the income or loss of the AOP/BOI, as computed under section 67A (1) is to be apportioned under the various heads of income in the

same manner in which the income or loss of the AOP/BOI has been determined under each head of income [Sec. 67A (2)].

(3) Can Interest paid by member on borrowed capital be claimed? [Section 67A(3)]

In computing the income of a member chargeable under the head "Profits and gains of business or profession" in respect of his share in the income of the AOP/BOI, any interest paid by the member on capital borrowed by him for the purposes of investment in the AOP/BOI can be deducted from his share.

(4) Can member claim chapter VI-A deductions which have already been claimed by AOP? [Section 80A(3)]

In computing the total income of an AOP/BOI if any deduction is admissible under Chapter VI-A, no deduction under that chapter can be claimed while computing the total income of a member of the AOP/BOI in relation to the share of that member in the income of AOP/BOI.

(5) Rebate from tax liability [Section 86]

Due to double taxation in the hands of members, rebate shall be given to the members from their personal tax liability under section 86 as per following formula:-

$$\text{Rebate} = \text{Share from AOP} \times \frac{\text{Total Tax of Member (including education cess)}}{\text{Total Income of Member}}$$

(6) Non-availability of rebate under section 86 in certain cases

However, where no income-tax is chargeable on the total income of the AOP/BOI, the shares of a member therein shall be fully chargeable to tax as part of his total income and no rebate shall be given.

(B) Case 2 :

(a) Tax rate applicable to AOP/BOI under Case 2

If all the followings conditions are satisfied, then AOP shall be taxed at maximum marginal rate (MMR)-30% plus surcharge. [i.e. 34.50% for **A.Y. 2018-19**]

- (1) Shares of members are determinate / known.
- (2) All members of AOP are subject to slab rate.
- (3) But, one or more members has a total (net) income exceeding exemption limit.

(b) Rules for computation tax liability of members of AOP under this case.

Once AOP shall be taxed at maximum marginal rate or any higher rate, share from AOP shall not be taxed in the hands of members- Section 86.

(C) Case 3 :

(a) Tax rate applicable to AOP/BOI under Case 3

If all the followings conditions are satisfied, then AOP shall be taxed at maximum marginal rate (MMR)- 30% plus surcharge. [i.e. 34.50% for **A.Y. 2018-19**]

- (1) Shares of members are determinate / known.
- (2) One or more members of the firm is
 - a. an Indian company, or;
 - b. a partnership firm or;
 - c. an AOP/BOI whose income is chargeable to tax at MMR/rate higher than MMR.

(b) Rules for computation tax liability of members of AOP under this case.

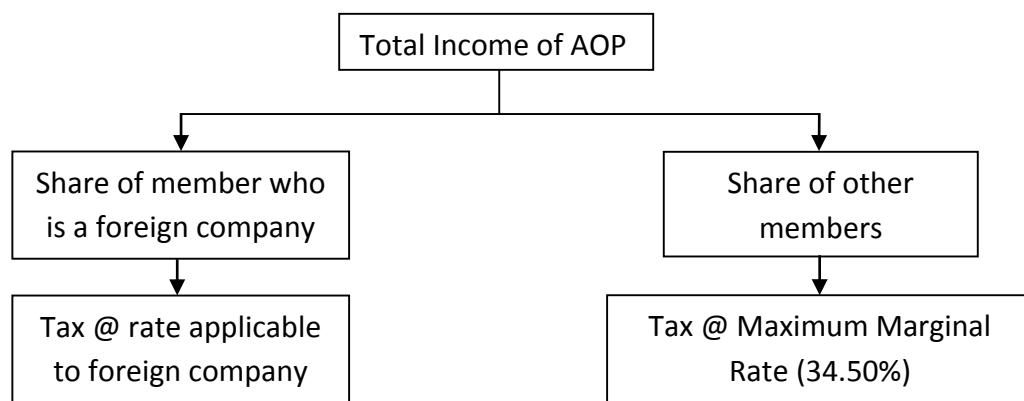
Once AOP shall be taxed at maximum marginal rate or any higher rate, share from AOP shall not be taxed in the hands of members- Section 86.

(D) Case 4 :**(a) Tax rate applicable to AOP/BOI under Case 4**

If following conditions are satisfied;

- (1) Shares of members are determinate / known.
- (2) One of the members is chargeable to tax at a rate higher than Maximum Marginal Rate (MMR).
{It is possible only when one of the members is a foreign company}

Then, divide the total income as under:

**(b) Rules for computation tax liability of members of AOP/ BOI under this case.**

Once AOP shall be taxed at maximum marginal rate or any higher rate, share from AOP shall not be taxed in the hands of members- Section 86.

(E) Case 5 :**(a) Tax rate applicable to AOP/BOI under Case 5**

If all the followings conditions are satisfied, then AOP shall be taxed at maximum marginal rate (MMR)- 30% plus surcharge. [i.e. 34.50% for **A.Y. 2018-19**]

- (1) Shares of members are indeterminate / unknown.
- (2) None of the members is a foreign company.

(b) Rules for computation tax liability of members of AOP / BOI under this case.

Once AOP shall be taxed at maximum marginal rate or any higher rate, share from AOP shall not be taxed in the hands of members- Section 86.

(F) Case 6 :**(a) Tax rate applicable to AOP/BOI under Case 6**

If all the followings conditions are satisfied, then entire income of AOP shall be taxed at the rate higher than maximum marginal rate i.e. 40%.

- (1) Shares of members are indeterminate / unknown.
- (2) One of the members is chargeable to tax at a rate higher than Maximum Marginal Rate (MMR).

(b) Rules for computation tax liability of Members under this case.

Once AOP shall be taxed at maximum marginal rate or any higher rate, share from AOP shall not be taxed in the hands of members- Section 86.

Practical 3

P, Q and R are individuals, who constitute an Association of Persons, sharing profit and losses in the ratio of 2:3:5. For the concerned previous year, the Profit and Loss account of the business was as under:

Particulars	Rs.	Particulars	Rs.
Cost of goods sold	47,50,000	Sales	54,00,000
Remuneration to:		Dividend from Indian companies	39,000
P	1,32,200	Capital gains: Short term	7,01,000
Q	1,72,500	Interest on Drawings:	
Employees	1,96,500	P	3,000
Interest to:		Q	1,450
P	59,400	R	3,550
Q	54,170		
R	43,000		
Other expenses	1,41,700		
Sales Tax Penalty	57,000		
Net profit	5,41,530		
	61,48,000		61,48,000

Additional information:

- (1) Other expense includes Rs. 30,000 paid in cash to an advertising agency for publicity.
- (2) Sales tax penalty was paid on 15th October of relevant assessment year. The penalty was imposed by the Sales-tax Officer for non-filing of returns by the due dates.

Compute total income and tax liability of AOP and individual members for the relevant assessment year under the following cases:

Situation 1 -Other incomes of members are given below:

Name of Members	Nature of income	Amount (Rs.)	LIC premium (Rs.)
P	Bank interest	57,200	24,000
Q	Interest on Government securities	54,400	19,000
R	Interest on company deposit	2,72,000	86,000

Situation 2 - The profit-sharing ratio of P, Q and R is 3 : 1 : 6. Other incomes of members are as follows:

Name of Members	Amount of income (Rs.)	Donation to P.M.N.R.F. (Rs.)	Contribution to PPF (Rs.)
P	26,000	6,000	1,000
Q	3,25,000	26,000	30,000
R	67,000	15,000	5,000

Situation 3 -One of the members, R is a foreign company and the profit-sharing ratio of P, Q and R Ltd is 2:3:5. Other income of the members are given below:

Name of Members	Amount (Rs.)
P	1,65,000
Q	8,30,000
R Ltd.	2,10,000

Situation 4—Suppose in 1st situation, shares of P, Q and R are not known.**Situation 5** - Suppose in 3rd situation, shares of P, Q and R Ltd. are not known.

Solution**Computation of Total Income of AOP**

Particulars	Rs.
Income under the head PGBP	
Net Profit as per Profit and Loss account	5,41,530
Less: Dividend [Exempt income]	(39,000)
Less: Short term capital gain [to be considered separately]	(7,01,000)
Add: Adv. Expenses [Section 40A(3)]	30,000
Add: Sales tax Penalty [Section 37(1)]	57,000
Add: Remuneration to P [Section 40ba)]	1,32,200
Add: Remuneration to Q [Section 40ba)]	1,72,500
Add: Interest to P (59,400-3000) [Section 40ba)]	56,400
Add: Interest to Q (54,170-1450) [Section 40ba)]	52,720
Add: Interest to R (43000-3550) [Section 40ba)]	39,450
Income under the head PGBP	3,41,800
Add: Short term Capital Gain	7,01,000
Gross Total Income	10,42,800
Less: Deductions under section 80C to 80U	Nil
Total Income	10,42,800

Situation 1:**(A) Computation of Tax Liability of AOP**

- (1) Shares of members are determinate /known. (i.e., 2:3:5)
- (2) All members of AOP are subject to slab rate.
- (3) None of the member has a total (net) income exceeding exemption limit. (Income from AOP shall not be considered at this stage)

Therefore, the income of AOP shall be taxed as per slab rate

Income	Tax Rate	Tax (Rs.)
0 - 2,50,000	-	-
2,50,000 to 5,00,000	5%	12,500
5,00,000 to 10,00,000	20%	1,00,000
10,00,000 to 10,42,800	30%	12,840
		1,25,340
Add: 4% Health & Education Cess		5,014
Tax Liability		1,30,354
Tax Liability (Round off)		1,30,350

(B) Computation of Share from AOP of Members and Tax Liability of Members**Calculation of Share from AOP**

Particulars	P	Q	R	Total
Interest (Net)	56,400	52,720	39,450	1,48,570
Remuneration	1,32,200	1,72,500	-	3,04,700
Profit (2:3:5)	1,17,906	1,76,859	2,94,765	5,89,530 (Balancing Figure)
TOTAL	3,06,506	4,02,079	3,34,215	10,42,800

Computation of Tax Liability of Members

Particulars	P (Rs.)	Q (Rs.)	R (Rs.)
Share from AOP	3,06,506	4,02,079	3,34,215
Income From Other Sources	57,200	54,400	2,72,000
Gross Total Income	3,63,706	4,56,479	6,06,215
Less: Section 80C	(24,000)	(19,000)	(86,000)
Total Income	3,39,706	4,37,479	5,20,215
Total Income (Rounded off)	3,39,710	4,37,480	5,20,220
Tax Calculation			
Upto 2,50,000	Nil	Nil	Nil
2,50,000 – 5,00,000 (5%)	4,485	9,374	12,500
5,00,000 – 5,20,220 (20%)	Nil	Nil	4,044
Sub-total	4,485	9,374	16,544
Less: Rebate under section 87A	(2,500)	Nil	Nil
Sub-total	1,985	9,374	16,544
Add: 4% Health & Education Cess	79	375	662
Sub-total	2,064	9,749	17,206
Less: Rebate under section 86 (Working Note)	(1,862)	(8,960)	(11,054)
Tax Liability	202	789	6,152
Tax Liability (Rounded off)	200	790	6,150

Working Note: Rebate under section 86

$$\text{Rebate} = \text{Share from AOP} \times \frac{\text{Total Tax of Member (including education cess)}}{\text{Total Income of Member}}$$

$$P = 3,06,506 \times \frac{2,064}{3,39,706}$$

$$= \text{Rs.} 1,862$$

$$Q = 4,02,079 \times \frac{9,749}{4,37,479}$$

$$= \text{Rs.} 8,960$$

$$R = 3,34,215 \times \frac{17,206}{5,20,215}$$

$$= \text{Rs.} 11,054$$

Situation 2**(A) Computation of Tax Liability of AOP**

- (1) Shares of members are determinate /known.
- (2) All members of AOP are subject to slab rate.
- (3) But, total (net) income of Mr. Q exceeds exemption limit.

Therefore, AOP shall be taxed at maximum marginal rate (MMR).i.e., 34.50%.

$$\text{Tax Liability} = \text{Rs.} 10,42,800 \times 34.50\%$$

$$= \text{Rs.} 3,59,766 + 4\% \text{ Health \& Education Cess}$$

$$= \text{Rs.} 3,59,766 + \text{Rs.} 14,391$$

$$= \text{Rs.} 3,74,157$$

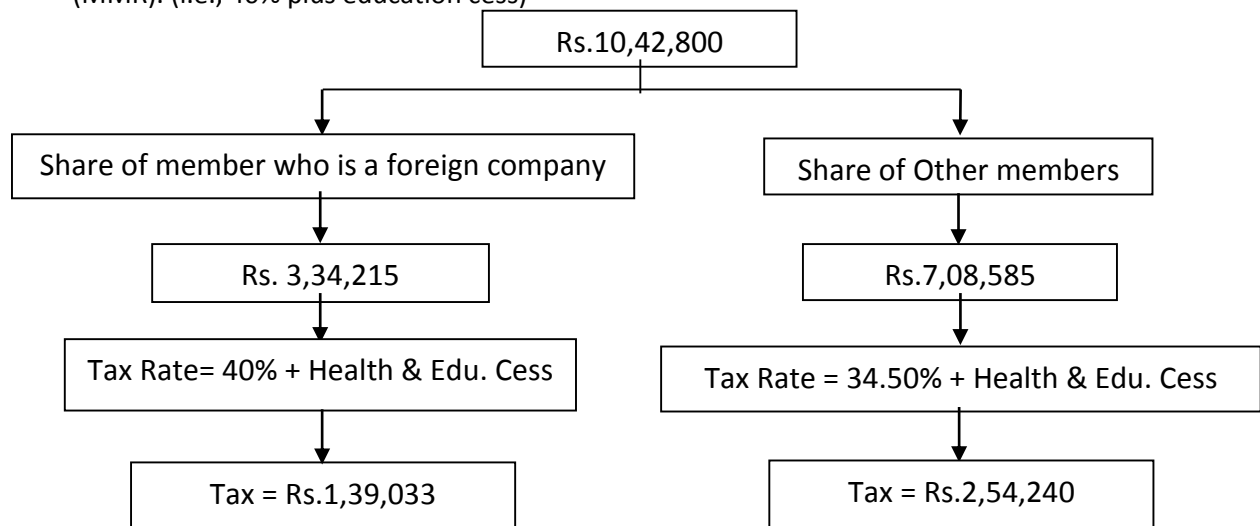
$$= \text{Rounded off to Rs. } 3,74,160$$

(B) Computation of Tax Liability of Members

Particulars	P (Rs.)	Q (Rs.)	R (Rs.)
Share from AOP [Section 86]	Not Taxable	Not Taxable	Not Taxable
Income From Other Sources	26,000	3,25,000	67,000
Gross Total Income	26,000	3,25,000	67,000
Less: Section 80C	(1,000)	(30,000)	(5,000)
Less: Section 80G	(6,000)	(26,000)	(15,000)
Total Income	20,000	2,69,000	47,000
Upto 2,50,000	Nil	Nil	Nil
2,50,000 – 5,00,000 (5%)	-	950	-
Sub-total	-	950	-
Less: Rebate 87A	-	(950)	-
Tax Liability	-	-	-

Situation 3**(A) Computation of Tax Liability of AOP**

- (1) Shares of members are determinate / known.
 (2) R Ltd. is a foreign company and chargeable to tax at a rate higher than Maximum Marginal Rate (MMR). (i.e., 40% plus education cess)



$$\begin{aligned}
 \text{Tax Liability} &= \text{Rs. 1,39,033} + \text{Rs. 2,54,240} \\
 &= \text{Rs. 3,93,273} \\
 &= \text{Rounded off to Rs. 3,93,270}
 \end{aligned}$$

(B) Computation of Tax Liability of Members

Particulars	P (Rs.)	Q (Rs.)	R Ltd. (Rs.)
Share from AOP [Section 86]	Not Taxable	Not Taxable	Not Taxable
Other Income	1,65,000	8,30,000	2,10,000
Gross Total Income	1,65,000	8,30,000	2,10,000
Less: Deduction	-	-	-
Total Income	1,65,000	8,30,000	2,10,000
Upto 2,50,000	Nil	Nil	NA
2,50,000 – 5,00,000 (5%)	-	12,500	NA
5,00,000 – 8,30,000 (20%)	-	66,000	
Tax Rate @40%	NA	NA	84,000

Sub-total	-	78,500	84,000
Add: Health & Education Cess (4%)	-	3,140	3,360
Tax Liability	-	81,640	87,360
Tax Liability (Rounded off)	-	81,640	87,360

Situation 4**(A) Computation of Tax Liability of AOP**

- (1) Shares of members are indeterminate / unknown.
- (2) All members of AOP are subject to slab rate.

Therefore, AOP shall be taxed at maximum marginal rate [MMR i.e. 33.60%].

$$\begin{aligned}
 \text{Tax Liability} &= \text{Rs.}10,42,800 \times 34.50\% \\
 &= \text{Rs.}3,59,766 + 4\% \text{ Education Cess} \\
 &= \text{Rs.}3,59,766 + \text{Rs.}14,391 \\
 &= \text{Rs.}3,74,157 \\
 &= \text{Rounded off to Rs. } \mathbf{3,74,160}
 \end{aligned}$$

(B) Computation of Tax Liability of Members

Particulars	P (Rs.)	Q (Rs.)	R (Rs.)
Share from AOP [Section 86]	Not Taxable	Not Taxable	Not Taxable
Income From Other Sources	57,200	54,400	2,72,000
Gross Total Income	57,200	54,400	2,72,000
Less: Section 80C	24,000	19,000	86,000
Total Income	33,200	35,400	1,86,000
Tax Liability	Nil	Nil	Nil

Situation 5**(A) Computation of Tax Liability of AOP**

- (1) Shares of members are indeterminate /unknown.
- (2) R. Ltd. a foreign company is chargeable to 40%

Therefore AOP shall be taxed @40%

$$\begin{aligned}
 \text{Tax Liability} &= \text{Rs.}10,42,800 \times 40\% \\
 &= \text{Rs.}4,17,120 + 4\% \text{ Education Cess} \\
 &= \text{Rs.}4,17,120 + \text{Rs.}16,685 \\
 &= \text{Rs.}4,33,805 \text{ rounded off to Rs. } \mathbf{4,33,810}
 \end{aligned}$$

(B) Computation of Tax Liability of Members

Particulars	P (Rs.)	Q (Rs.)	R Ltd. (Rs.)
Share from AOP [Section 86]	Not Taxable	Not Taxable	Not Taxable
Other Income	1,65,000	8,30,000	2,10,000
Gross Total Income	1,65,000	8,30,000	2,10,000
Less: Deduction	-	-	-
Total Income	1,65,000	8,30,000	2,10,000

DIVISION C

13 - ASSESSMENT OF AOP OR BOI

Upto 2,50,000	Nil	Nil	NA
2,50,000 – 5,00,000 (5%)	-	12,500	NA
5,00,000 – 8,30,000 (10%)	-	66,000	
Tax Rate @40%	NA	NA	84,000
Total	-	78,500	84,000
Add: Health & Education Cess (4%)	-	3,140	3,360
Tax Liability	-	81,640	87,360
Tax Liability (Rounded off)	-	81,640	87,360

Readers Note:

14 - ASSESSMENT OF CO-OPERATIVE SOCIETIES**14.1 DEDUCTION IN RESPECT OF INCOME OF CO-OPERATIVE SOCIETIES****Section:- 80P**

In case of co-operative societies, the gross total income includes any income mentioned in following paras, then,

(1) Section 80P(2)(a)

Co-operative society engaged in-

- (i) carrying on the business of banking or providing credit facilities to its members; or
- (ii) a cottage industry; or
- (iii) the marketing of the agricultural produce grown by its members; or
- (iv) the purchase of agricultural implements, seeds, livestock or other articles intended for agriculture for the purpose of supplying them to its members; or
- (v) the processing, without the aid of power, of the agricultural produce of its members; or
- (vi) the collective disposal of the labour of its members; or
- (vii) fishing or allied activities, that is to say, the catching, curing, processing, preserving, storing or marketing of fish or the purchase of materials and equipment in connection therewith for the purpose of supplying them to its members,

whole (100%) of the amount of profits and gains of business attributable to any one or more of such activities is deductible..

However, in case of co-operative societies falling under clauses (vi) and (vii) above, the deduction, is available subject to the condition that the rules and bye-laws of the society restrict the voting rights to the following classes of its members, namely:-

- (i) the individuals who contribute their labour or ,as the case may be, carry on the fishing or allied activities;
- (ii) the co-operative credit societies which provide financial assistance to the society;
- (iii) the State Government.

(2) Section 80P(2)(b)

Co-operative society, being a primary society engaged in supplying milk, oilseeds, fruits or vegetables raised or given by its members to -

- (i) a federal co-operative society, being a society engaged in the business of supplying milk, oilseeds, fruits or vegetables, as the case may be; or
- (ii) the Government or a local authority; or
- (iii) a Government company as defined in section 617 of the Companies Act, 1956 or a statutory corporation (being a company or corporation engaged in supplying milk, oilseeds, fruits or vegetables as the case may be, to the public);

whole (100%) of the amount of profits and gains of business such business is deductible..

(3) Section 80P(2)(c)

Co-operative society engaged in activities other than those specified in Para No. 19.1 and Para No. 19.2 above, either independently of, or in addition to, all or any of the activities so specified, so much of its profits and gains attributable to such activities as does not exceed -

- (i) where such co-operative society is a consumers' co-operative society Rs.1,00,000;
- (ii) in case of any other co-operative society Rs.50,000;

is deductible.

(4) Section 80P(2)(d)

Any income by way of interest or dividends derived by the co-operative society from its investments in any other co-operative society is deductible.

(5) Section 80P(2)(e)

Any income derived by the co-operative society from the letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities is deductible.

(6) Section 80P(2)(f)

Any income by way of interest on securities and income from house property is deductible provided gross total income of the society does not exceed Rs. 20,000.

However, deduction under this clause is not available to the following societies:

- (a) a housing society or
- (b) an urban consumers' society or
- (c) a society carrying on transport business or
- (d) a society engaged in the performance of any manufacturing operations with the aid of power.

14.2 DOUBLE DEDUCTION NOT PERMISSIBLE**Section:- 80P(3)**

Where an assessee is also entitled to deduction u/s 80-IA, deduction u/s 80P shall be allowed with reference to such profits and gains as reduced by the deduction allowed under section 80-IA.

14.3 PROVISIONS OF SECTION 80P SHALL NOT APPLY TO ANY CO-OPERATIVE BANK**Section:- 80P(4)**

The provisions of this section shall not apply in relation to any co-operative bank other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank.

Explanation

For the purposes of this sub-section,-

- (a) "Co-operative Bank" and "Primary agricultural credit society" shall have the meanings respectively assigned to them in part V of the Banking Regulation Act, 1949;
- (b) "Primary Co-operative agricultural and rural development bank" means a society having its area of operation confined to taluka and the principal object of which is to provide for long-term credit for agricultural and rural development activities.

14.4 RATES OF TAX

Total Income	Rate of Income Tax
Upto Rs.10,000	10%
Next Rs.10,000	20%
Balance Income	30%

Surcharge: Surcharge is 12% of income-tax if total income exceeds Rs.1 crore.

Health and Education Cess: It is 4% of (income-tax and surcharge).

Practical 1

X Cooperative Society Ltd., markets agricultural produce supplied to it by its members. Its profit and loss Account showed a profit of Rs.10 lakhs on sales of Rs.100 lakhs. (It can be assumed that profits accrued uniformly on sales). The Society's claim for exemption of income from the tax was examined by the Assessing Officer who found that the sales composed of:

Rs.70 lakhs of produce raised by the Society's own members in their agricultural fields; and Rs.30 lakhs of produce bought by the members from the open market and supplied to the Society.

The Assessing Officer wants to deny exemption under section 80P(1) in regard to profits on bought out goods supplied by members to the Society. Is the assessing officer's view correct in law? Discuss.

Solution

As per section 80P, 100% deduction is allowed to the co-operative Society if it earns any income from the activity of marketing of the agricultural produce grown by its members. In the present case, the view of the Assessing Officer for denying exemption on income earned on the sale composed of Rs.30 lakhs of produce bought by the members from the open market and supplied to the society is correct.

Readers Note:**Practical 2**

Kheda Agriculturists Co- operative Society furnishes the following particulars, determine its total income:

- (a) Income from processing of agricultural produce without aid of power: Rs.18,000;
- (b) Income from marketing agricultural produce grown by its members: Rs.5,000;
- (c) Dividends from another co – operative society; Rs.60,000;
- (d) Income from letting of godown: Rs.12,000; and
- (e) Income from agency business: Rs.1,25,000.

Solution

Particulars	Rs.	Rs.
Income from letting of godowns	12,000	
Business income:		
- From processing	18,000	
- From marketing	5,000	
- From agency	1,25,000	1,60,000
Dividend Income		60,000
Gross Total Income		2,20,000
Less: Deductions in respect of income from		
(a) processing of agricultural produce [Sec. 80P(2)(a)]	18,000	
(b) marketing of agricultural produce [Sec.80P(2)(a)]	5,000	
(c) agency business [sec. 80P(2)(c)]	50,000	
(d) dividend [sec. 80P(2)(d)]	60,000	
(e) letting of godowns [sec. 80P(2)(e)]	12,000	1,45,000
Total Income		75,000

Readers Note:

15 - ASSESSMENT OF COMPANIES

15.1 MINIMUM ALTERNATE TAX (MAT) AND ITS APPLICABILITY**Section:-** 115JB(1), 115JB(5A), 115JB(6) and 115JB(7)

The concept of MAT under the Income Tax Act is very wide. Therefore, it has been divided into following paras for better understanding.

Para No.	Description
Para 15.1	MAT and its applicability
Para 15.1A	Book Profit – How to Determine?
Para 15.1B	Special Adjustments to arrive at book profit for IND AS Compliant companies
Para 15.1C	Special Adjustments to arrive at book profit for demerged company and resulting company
Para 15.1D & E	Computation of Tax Liability

Section 115JB has been inserted from the assessment year 2001-02. It provides that in case the income-tax payable on total income is less than 18.5 per cent of the book profit, **such book profit shall be deemed to be the 'total income', chargeable to tax at the rate of 18.5 per cent (plus SC+EC).**

Section 115JB (7) provides that if the assessee is a unit located in International Financial Services Centre and derives its income solely in convertible foreign exchange, then book profit shall be taxed at the rate of **9 per cent** instead of **18.5 percent**.

Practical 1

Whether the provisions of MAT are applicable to Life Insurance Company?

Solution

Amendment by Finance Act, 2012: with retrospective effect from A.Y. 2001-02

Section 115JB(5A) provides that that any income accruing or arising to a company from life insurance business referred to in section 115B would not be subject to MAT.

Readers Note:

Practical 2

Whether the provisions of MAT are applicable to an entrepreneur in SEZ or Developer of SEZ?

Solution

The effect of the proviso to section 115JB(6) inserted Finance Act, 2011 is that MAT provisions are applicable to the income accruing or arising from any business carried on, or services rendered by an entrepreneur in SEZ or Developer of SEZ with effect from A.Y. 2012-13 and onwards .

Readers Note:

Practical 3

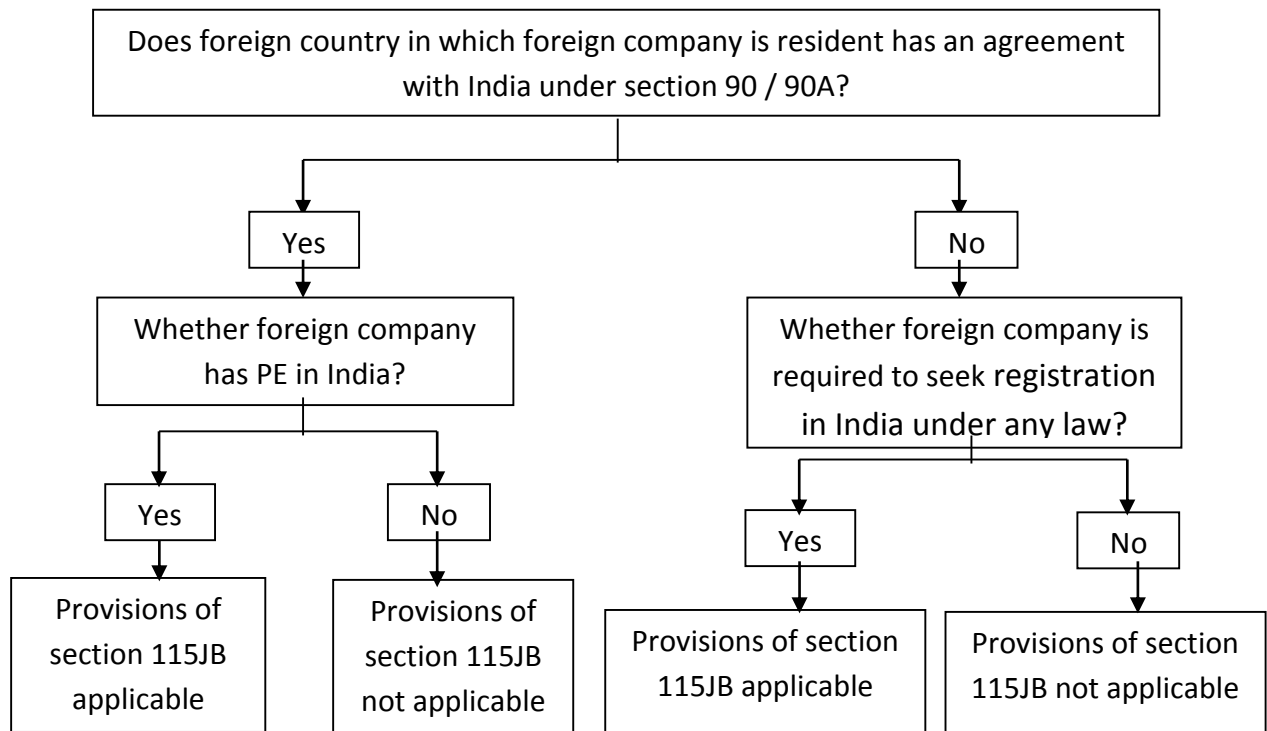
Whether the provisions of MAT are applicable to foreign companies or not?

Solution**Amendment by Finance Act, 2016: with retrospective effect from A.Y. 2001-02**

Provisions of section 115JB shall not be applicable to a foreign company if-

- (a) The assessee is a resident of a foreign country or specified territory with which India has an agreement under section 90/90A and the assessee does not have a permanent establishment in India in accordance with the provisions of such agreement or
- (b) The assessee is a resident of a foreign country or specified territory with which India does not have an agreement under section 90/90A and the assessee is not required to seek registration in India under any law for the time being in force relating to companies.

To sum up,

**Readers Note:****Practical 4**

Singapore Airlines Inc (SAI), a foreign company derives its income solely from the operations of aircrafts in India. It seeks your advice on applicability of MAT.

Does your answer differ, if SAI also provides technical services to Indian Airlines for maintenance of aircrafts in addition to the above activity?

Solution

Income derived from the operations of aircrafts falls under section 44BBA of the Act. If it is the only income derived by (SAI) during the previous year, then MAT provisions (section 115JB) are not applicable in view of the **retrospective amendment made by Finance Act, 2018 w.e.f. A.Y. 2001-02** which reads as under: -

Explanation 4A to section 115 JB(2)—"For the removal of doubts, it is hereby clarified that the provisions of this section shall not be applicable and shall be deemed never to have been applicable to an assessee, being a foreign company, where its total income comprises solely of profits and gains from business referred to in section 44B or section 44BB or section 44BBA or section 44BBB and such income has been offered to tax at the rates specified in those sections.

However, SAI is subject to MAT provisions if it derives any other income in addition to the operation of aircrafts in India.

Readers Note:

15.1A | BOOK PROFIT – HOW TO DETERMINE?**Section:- 115JB(2)**

Profit as shown in statement of profit and loss (after few adjustments) is book profit.

(A) Meaning of “Profit as shown in statement of profit and loss”

Profit in case of –

- (a) any insurance or banking company or any company engaged in the generation or supply of electricity (or any other class of company for which a different form of statement of profit and loss has been specified in or under the Act governing such class of company), shall be calculated on the basis of statement of profit and loss prepared in accordance with the provisions of their regulatory Acts, or
- (b) any other company, shall be calculated on the basis of statement of profit and loss prepared in accordance with Schedule III to the Companies Act, 2013.

(B) Few adjustments to Profit as shown in statement of profit and loss to convert it into Book Profit
[Explanation to section 115JB (2)]**Positive Adjustments –**

Profit as shown in statement of profit and loss is to be increased by the following amounts if debited to the statement of profit and loss:

- (1) the amount of income-tax paid or payable, and the provisions therefore; or
Explanation: Amount of income tax shall include,
 - (i) any tax on distributed profits under section 115-O or on distributed income u/s 115-R
 - (ii) any interest charged under this Act
 - (iii) Surcharge, if any has levied by the central Acts from time to time.
 - (iv) Education cess on income tax, if any has levied by the Central Acts from time to time
Secondary and higher education cess on Income Tax, if any levied by the Central Acts from time to time.
- (2) the amounts carried to any reserves, by whatever name called; or
- (3) the amount or amounts set aside to provisions made for meeting liabilities, other than ascertained liabilities; or
- (4) the amount by way of provision for losses of subsidiary companies; or
- (5) the amount or amounts of dividends paid or proposed; or
- (6) the amount or amounts of expenditure relatable to any income to which section 10 [not being provisions contained under section 10(38)] or 11 or 12 apply.
- (7) the amount or amounts of expenditure relatable to, income, being share of the assessee in the income of an association of persons or body of individuals, on which no income-tax is payable in accordance with the provisions of section 86; or
- (8) the amount or amounts of expenditure relatable to income accruing or arising to an assessee, being a foreign company, from,—
 - (A) the capital gains arising on transactions in securities; or
 - (B) the interest, royalty or fees for technical services chargeable to tax at the rate or rates specified in Chapter XII,

- if the income-tax payable thereon in accordance with the provisions of this Act (other than the provisions governing MAT) is less than 18.5%; or
- (9) the amount representing,
- notional loss on transfer of a capital asset, being share of a special purpose vehicle to a business trust in exchange of units allotted by the trust referred to in clause (xvii) of section 47 or
 - the amount representing notional loss resulting from any change in carrying amount of said units or
 - the amount of loss on transfer of units referred to in clause (xvii) of section 47
- (10) the amount or amounts of expenditure relatable to income by way of royalty in respect of patent chargeable to tax under section 115BBF
- (11) the amount of depreciation
- (12) The amount of deferred tax and the provisions therefore
- (13) The amount or amounts set aside as provision for diminution in the value of any asset;
-
- (14) Amount standing in revaluation reserve relating to revalued asset on the retirement or disposal of such asset if it is not credited to the statement of profit and loss;
- (15) the amount of gain on transfer of units referred to in clause (xvii) of section 47 computed by taking into account the cost of the shares exchanged with units referred to in the said clause or the carrying amount of the shares at the time of exchange where such shares are carried at a value other than the cost through profit or loss account, as the case may be.

Negative Adjustments–

Profit as shown in the statement of profit and loss is to be reduced by the following amounts:

- the amount withdrawn from reserves or provisions, if any such amount is credited to the statement of profit and loss; or (Provided book profits was increased in the year of creation of reserve or reserve was created by way of debit to statement of profit and loss)
- the amount of income to which any of the provisions of section 10 [not being provisions contained u/s 10(38)] or 11 or 12 apply, if any such amount is credited to the statement of profit and loss; or
- the amount of depreciation debited to the statement of profit and loss (excluding the depreciation on account of revaluation of assets); or
- the amount withdrawn from revaluation reserve and credited to the statement of profit and loss, to the extent it does not exceed the amount of depreciation on account of revaluation of assets referred to in clause (3) above; or
- the amount of income, being the share of the assessee in the income of an association of persons or body of individuals, on which no income-tax is payable in accordance with the provisions of section 86, if any, such amount is credited to the statement of profit and loss; or
- the amount of income accruing or arising to assessee, being a foreign company, from,—
 - the capital gains arising on transactions in securities; or
 - the interest, royalty or fees for technical services chargeable to tax at the rate or rates specified in Chapter XII,
 if the income-tax payable thereon in accordance with the provisions of this Act (other than the provisions governing MAT) is less than 18.5%; or

- (7) the amount representing,—
- (A) notional gain on transfer of a capital asset, being share of a special purpose vehicle to a business trust in exchange of units allotted by that trust referred to in clause (xvii) of section 47; or
- (B) notional gain resulting from any change in carrying amount of said units; or
- (C) gain on transfer of units referred to in clause (xvii) of section 47, if any, credited to the statement of profit and loss; or
- (8) the amount of loss on transfer of units referred to in clause (xvii) of section 47 computed by taking into account the cost of the shares exchanged with units referred to in the said clause or the carrying amount of the shares at the time of exchange where such shares are carried at a value other than the cost through profit or loss account, as the case may be; or
- (9) the amount of income by way of royalty in respect of patent chargeable to tax under section 115BBF; or
- (10) *The aggregate amount of unabsorbed depreciation and loss brought forward in case of a company against whom an application for corporate insolvency resolution process has been admitted by the Adjudicating Authority under section 7 or section 9 or section 10 of the Insolvency and Bankruptcy Code, 2016.*
- Explanation.—For the purposes of this clause, the expression "Adjudicating Authority" shall have the meaning assigned to it in section 5(1) of the Insolvency and Bankruptcy Code, 2016 and the loss shall not include depreciation; or]*
- [Inserted by Finance Act, 2018 w.r.e.f. A.Y. 2018-19]*
- (11) the amount of loss brought forward or unabsorbed depreciation, whichever is less, as per books of account
- Explanation.—For the purposes of this clause,—
- (a) the loss shall not include depreciation;
- (b) the provisions of this clause shall not apply if the amount of loss brought forward or unabsorbed depreciation is nil ;or
- (12) the amount of profits of sick industrial company for the assessment year commencing from the assessment year relevant to the previous year in which the said company has become a sick industrial company under section 17(1) of the Sick Industrial Companies (Special Provisions) Act, 1985 and ending with the assessment year during which the entire net worth (i.e., paid-up capital plus free reserves) of such company becomes equal to or exceeds the accumulated losses;
- (13) Amount of deferred tax, if any such amount is credited to statement of profit and loss.

15.1B	SPECIAL ADJUSTMENTS TO ARRIVE AT BOOK PROFIT FOR IND AS COMPLIANT COMPANIES IN THE YEAR OF ADOPTION AND THEREAFTER

Section:- 115JB(2A) and (2C)

The effect of sub-section (2A) of section 115JB is summarized as under:

- (i) The adjustments arising on account of transition to Ind AS from existing Indian GAAP is required to be recorded directly in Other Equity at the date of transition to Ind AS. Several of these items would subsequently never be reclassified to the statement of profit and loss / included in the computation of book profits. Accordingly, the following treatment is proposed:

- a) Those adjustments recorded in other comprehensive income and which would subsequently be reclassified to the profit and loss, shall be included in book profits in the year in which these are reclassified to the profit and loss;
- b) Those adjustments recorded in other comprehensive income and which would never be subsequently reclassified to the profit and loss shall be included in book profits as specified hereunder-

Sl. No.	Items	Point of time
1.	Changes in revaluation surplus of Property, Plant or Equipment (PPE) and Intangible assets (Ind AS 16 and Ind AS 38)	To be included in book profits at the time of realization / disposal / retirement or otherwise transferred
2.	Gains and losses from investments in equity instruments designated at fair value through other comprehensive income (Ind AS 109).	To be included in book profits at the time of realization / disposal / retirement or otherwise transferred.
3.	Remeasurements of defined benefit plans (Ind AS 19)	To be included in book profits equally over a period of five years starting from the year of first time adoption of Ind AS
4.	Any other item	To be included in book profits equally over a period of five years starting from the year of first time adoption of Ind AS

- c) All other adjustments recorded in Reserves and Surplus (excluding Capital Reserve and Securities Premium Reserve) as referred to in Division II of Schedule III of Companies Act, 2013 and which would otherwise never subsequently be reclassified to the statement of profit and loss, shall be included in the book profits, equally over a period of five years starting from the year of first time adoption of Ind AS subject to the following—

(a) PPE and intangible assets at fair value as deemed cost

An entity may use fair value in its opening Ind AS Balance Sheet as deemed cost for an item of PPE or an intangible asset as mentioned in paragraphs D5 and D7 of Ind AS 101. In such cases the treatment shall be as under—

- The existing provisions for computation of book profits under section 115JB of the Act provide that in case of revaluation of assets, any impact on account of such revaluation shall be ignored for the purposes of computation of book profits.
Further, the adjustments in retained earnings on first time adoption with respect to items of PPE and Intangible assets shall be ignored for the purposes of computation of book profits.
- Depreciation shall be computed ignoring the amount of aforesaid retained earnings adjustment.
- Similarly, gain/loss on realisation/ disposal/ retirement of such assets shall be computed ignoring the aforesaid retained earnings adjustment.

(b) Investments in subsidiaries, joint ventures and associates at fair value as deemed cost

An entity may use fair value in its opening Ind AS Balance Sheet as deemed cost for investment in a subsidiary, joint venture or associate in its separate financial statements as mentioned in paragraph D15 of Ind AS 101. In such cases retained earnings adjustment shall be included in the book profit at the time of realisation of such investment.

(c) Cumulative translation differences

- An entity may elect a choice whereby the cumulative translation differences for all foreign operations are deemed to be zero at the date of transition to Ind AS. Further, the gain or loss on

a subsequent disposal of any foreign operation shall exclude translation differences that arose before the date of transition to Ind AS and shall include only the translation differences after the date of transition.

- In such cases, to ensure that such Cumulative translation differences on the date of transition which have been transferred to retained earnings, are taken into account, these shall be included in the book profits at the time of disposal of foreign operations as mentioned in paragraph 48 of Ind AS 21.

(ii) All other adjustments to retained earnings at the time of transition (including for example, Decommissioning Liability, Asset retirement obligations, Foreign exchange capitalisation/ decapitalization, Borrowing costs adjustments etc.) shall be included in book profits, equally over a period of five years starting from the year of first time adoption of Ind AS.

(iii) Any deferred tax adjustments recorded in Reserves and Surplus on account of transition to Ind AS shall also be ignored.

‡ Circular No. 24/2017 dated 25.07.2017 ‡

Clarifications on computation of book profit for the purposes of levy of Minimum Alternate Tax (MAT) under section 115JB of the Income-Tax Act, 1961 for IND AS compliant companies

After amendment in section 115JB for computation of book profit for the purposes of levy of Minimum Alternate Tax (MAT) for Indian Accounting Standards (Ind AS) compliant companies, CBDT received representations from various stakeholders seeking clarifications on certain issues arising therefrom.

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 profits for the purposes of MAT?

Answer: Since MTM gains recognised through profit or loss on FVTPL classified 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 115JB(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 point 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 start 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 application 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 depreciation 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 decreased, 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 whatever 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.

15.1C SPECIAL ADJUSTMENTS TO ARRIVE AT BOOK PROFIT IN CASE OF “DEMERGED COMPANY” AND “RESULTING COMPANY”

Section:- 115JB(2A) (c) and (d), 115JB(2B)

(i) Adjustment to be made while computing book profit of “demerged company” :- clause (c) and (d) of Section 115JB(2A)

Appendix A of Ind AS 10 provides that any distributions of non-cash assets to shareholders (for example, in a demerger) shall be accounted for at fair value. The difference between the carrying value of the assets and the fair value is recorded in the statement of profit and loss. Correspondingly, the reserves are debited at fair value to record the distribution as a 'deemed dividend' to the shareholders. As there is a corresponding adjustment in retained earnings, this difference arising on demerger shall be excluded from the book profits. (i.e. amount debited to the statement of profit and loss on this account shall be increased and amount credited to the statement of profit and loss on this account shall be reduced while computing book profit in the hands of demerged company)

(ii) Adjustment to be made while computing book profit of “resulting company” :- Section 115JB(2B)

In the case of a resulting company, where the property and the liabilities of the undertaking or undertakings being received by it are recorded at values different from values appearing in the books of account of the demerged company immediately before the demerger, any change in such value shall be ignored for the purpose of computing of book profit of the resulting company.

15.1D COMPUTATION OF TAX LIABILITY

Step 1: Book Profit	Compute Book Profit as per Section 115JB
Step 2: MAT Liability	Compute tax @ 18.50% on Book Profit + (Surcharge) + (H.E.C)
Step 3: Total Income	Compute total income of the company as per the provisions of Income Tax Act, 1961.
Step 4: Regular Tax Liability	Find out Regular tax liability of the company applying tax rates as per para No. 15.3E.
Step 5: Tax Payable	Tax Liability shall be higher of the step 2 or step 4

REMARK:

In the case of a company, if tax liability is governed by MAT provisions, then book profit is taken as total income.

15.1E TAX RATES APPLICABLE FOR STEP 4

Section:- Annual Finance Act and section 115BA

(A) Income Tax Rates

	Domestic companies		Foreign companies
	If Total Turnover or Gross Receipts in P.Y.2016-17 <u>does not exceed</u> Rs.250 Crore	If Total Turnover or Gross Receipts in P.Y.2016-17 <u>exceeds</u> Rs.250 Crore	
	Tax rates	Tax rates	
Short Term Capital Gain u/s.111A	15% + SC+H.E.C	15% + SC+H.E.C	15%+ SC+H.E.C
Long-term capital gain u/s. 112	20%+SC+H.E.C	20% +SC+H.E.C	20%+ SC+H.E.C
Long term capital gain u/s. 112A	10% +SC+ H.E.C	10% +SC+H.E.C	10% +SC+H.E.C
Winnings from lotteries	30% + SC+H.E.C	30% + SC+H.E.C	30%+ SC+H.E.C
Other income	25%+ SC+H.E.C	30%+ SC+H.E.C	40%+ SC+H.E.C

(B) Tax on income of certain domestic companies.[Section 115BA]

Under this section, a domestic company, subject to following conditions, may opt for tax rate of 25 per cent. *[However, special rates of tax under ~~section 111A and 112~~ (Chapter XII) shall continue to apply to the company opted for section 115BA – modified by Finance Act, 2018 w.r.e.f. 01-04-2017] –*

- (1) The company has been set-up and registered on or after March 1, 2016
- (2) The company is not engaged in any business other than the business of manufacture or production of any article or thing and research in relation to, or distribution of such article or thing manufactured or produced by it.
- (3) Total income of the company has been computed
 - **without claiming** additional depreciation and deductions under section 10AA, section 32AC, section 32AD, section 33AB, section 33ABA, 35(1) (ii), Section 35(1) (ia), Section 35(1) (iii), Section 35 (2AA), Section 35 (2AB), section 35AC, section 35AD, section 35CCC, section 35CCD and sections 80C to 80U [Except section 80JJAA]

- **without adjusting** brought forward loss from any earlier year (if such loss pertains to any deduction under the aforesaid sections). Moreover, such loss will not be carried forward.
- **after claiming** depreciation under section 32 [By notification no. 103/2016, depreciation claim has been restricted to 40% in case of block of assets where the prescribed rate of depreciation is more than 40%]

(4) This option shall be exercised on or before the due date for furnishing the first of the returns of income, which the company is required to furnish under the Act.

(5) Once the Company has exercised the option for any previous year, it cannot be subsequently withdrawn for the same or any other previous year.

(C) Surcharge

Surcharge is applicable if total income (or Book Profit) exceeds Rs. 1 crore. The rates of surcharge are as under:-

Type of Company	If Total Income / Book Profit exceeds Rs. 1 crore but does not exceed Rs. 10 crore	If Total Income or Book Profit exceeds Rs. 10 crore
Domestic company	7%	12%
Foreign company	2%	5%

(D) Health and Education Cess

It is 4% of (income-tax and surcharge).

Practical 5

PQR Ltd. is engaged in manufacturing of goods. It provides following information for the previous year **2018-19**.

Profit & Loss Account

Particulars	Rs.	Particulars	Rs.
Cost of Goods sold	7,02,52,000	Sales	7,36,19,350
Entertainment Expenses	19,500	Interest on Fixed Deposit	1,54,900
Traveling Expenses	31,500	Dividend (from Indian Companies)	1,00,000
Salary & Wages	1,75,000	Deferred Tax	25,000
Salary to Directors	4,50,000	Share from AOP (where AOP had paid tax at Maximum Marginal Rate)	41,100
Professional fees	29,000		
Depreciation	5,17,000		
Provision for Bad and doubtful Debts	16,000		
Penalty under Income-Tax Act	10,000		
Interest for late filing of return	2,000		
Wealth-Tax (P.Y. 2014-15)	15,000		
Outstanding custom duty	21,000		
Provision for unascertained liabilities	75,000		
Loss of subsidiary company	39,000		
Provision for Income-Tax	2,25,000		
Proposed Dividend and CDT	64,350		
Net Profit	19,99,000		
	7,39,40,350		7,39,40,350

Additional Information

- (1) Depreciation of Rs.5,17,000 includes depreciation of Rs.17,000 on account of upward revaluation of fixed asset.
- (2) Brought forward loss and unabsorbed depreciation as per books of accounts is Rs.2,10,000 and Rs.6,000 respectively.
- (3) Depreciation allowable under section 32 of Income Tax Act was Rs. 5,36,000
- (4) Brought forward business loss for tax purpose Rs. 13,52,000
- (5) Brought forward unabsorbed depreciation for tax purpose Rs. 13,000
- (6) Company is eligible for deduction under section 80-IC @ 30%
- (7) Total turnover of the company for the previous year **2016-17** was Rs. 6.05 Cr.

Compute tax liability.

Solution**Step 1: Computation of Book Profit**

Particulars	Rs.	Rs.
Net Profit as per Profit & Loss Account		19,99,000
Add: Positive Adjustments		
Depreciation	5,17,000	
Provision for Bad and doubtful Debts	16,000	
Interest for late filing of income tax return	2,000	
Provision for unascertained liabilities	75,000	
Loss of subsidiary company	39,000	
Provision for Income Tax	2,25,000	
Proposed Dividend and CDT	64,350	9,38,350
Less: Negative Adjustments		
Dividend from Indian Companies	(1,00,000)	
Deferred Tax	(25,000)	
Income by way of share in income of AOP (which is not subject to tax)	(41,100)	
Depreciation (excluding depreciation on account of revaluation)	(5,00,000)	
Brought forward loss or unabsorbed depreciation whichever is lower [as per books of accounts]	(6,000)	(6,72,100)
Book Profit		22,65,250

Step 2: Computation of MAT Liability

Particulars	Rs.
MAT @18.5% of Book Profit (Rs. 22,65,250)	4,19,071
Add: Health & Education Cess: (4%)	16,763
MAT Liability	4,35,834

Step 3. Computation of total income

Particulars	Rs.)
<u>Income Under head PGBP</u>	
Net Profit as per profit and loss account	19,99,000

Less: Interest on Fixed Deposit (to be considered under "IFOS")	(1,54,900)
Less: Dividend from Indian Companies (Exempt)	(1,00,000)
Less: Differed Tax	(25,000)
Less: Share from AOP (Not taxable)	(41,100)
Add: Depreciation	5,17,000
Add: Provision for bad and doubtful debts	16,000
Add: Penalty under Income Tax Act	10,000
Add: Interest for late filing of return	2,000
Add: Wealth Tax (P.Y. 2014-15)	15,000
Add: Custom Duty (Assuming that it has not paid before due date of filing return)	21,000
Add: Provision for unascertained liability	75,000
Add: Losses of subsidiary	39,000
Add: Provision for Income Tax	2,25,000
Add: Proposed Dividend and CDT	64,350
Sub-total	26,62,350
Less: Depreciation as per Income Tax	(5,36,000)
Balance	21,26,350
Less: brought forward Business Loss	(13,52,000)
Balance	7,74,350
Less: unabsorbed depreciation	(13,000)
Income Under the head PGBP	7,61,350
Add: Income from Other Sources (FD Interest)	1,54,900
Gross total income	9,16,250
Less: Deduction under section 80IB (30% of PGBP)	2,28,405
Total Income	6,87,845

Step 4: Computation of Regular Tax Liability

Particulars	Rs.
Regular tax @ 25% of Total Income	1,71,961
Add: Health & Education Cess: (4%)	6,878
Regular tax liability	1,78,839

Step 5: Final Tax Payable

Particulars	Rs.
MAT Liability as per Step 2	4,35,834
Regular Tax Liability as per Step 4	1,78,839
Whichever is higher	4,35,834

Readers Note:**Practical 6**

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:

(i) Items debited to Statement of Profit and Loss:

Sr. No.	Particulars	Rs.
(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:

Sr. 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 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.

Solution**Step 1. Computation of Book Profit**

Particulars	Rs.
Net Profit as per profit and loss account	15,00,000
<u>Positive Adjustments</u>	
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	1,05,000
Depreciation	3,60,000
<u>Negative Adjustments</u>	
Share in income of an AOP as a member	(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 dep. or b/f business loss, whichever is less, as per the books of account. [Here, unabsorbed dep. is Rs. 4,00,000 while b/f business loss Rs. 6,00,000]	(4,00,000)
Book Profit	13,25,000

Step2. Computation of MAT Liability

Particulars	Rs.
MAT @18.5% of Book Profit (Rs. 13,25,000)	2,45,125
Add: Health & Education Cess: (4%)	9,805
MAT Liability	2,54,930
MAT Liability (Rounded Off)	2,54,930

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 thereunder, the same cannot be adjusted while computing book profit:
 - Interest to financial institution (unpaid before filing of return) and
 - Penalty for infraction of law
 - Capital gains credited to profit and loss account even if it is exempt under section 54EC of the Act. **[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.)]**
- (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.

Readers Note:**15.2 | SCHEME OF MAT CREDIT****Section:- 115JAA**

Scheme of MAT Credit, its set off and rules of carry forward is as under:-

1. When company pays tax under MAT, the tax credit shall be an amount which is the difference between the amount payable under MAT and the regular tax.
However, where the amount of tax credit in respect of any income-tax paid in any country or specified territory outside India, under section 90 or section 90A or section 91, allowed against the tax payable under MAT exceeds the amount of such tax credit admissible against the regular tax payable by the assessee, then, while computing the amount of MAT credit, such excess amount shall be ignored. **(Amendment by Finance Act, 2017 effective from assessment year 2018-19)**
2. MAT credit will be allowed to be carried forward for a period of ten assessment years immediately succeeding the assessment year in which MAT credit is available. However, with effect from the assessment year 2018-19, MAT credit will be allowed to be carried forward for a period of 15 assessment years. **(Amendment by Finance Act, 2017)**
3. If, in any subsequent assessment year, regular tax becomes payable, then, the difference between the regular tax and tax computed under MAT for that year shall be available as set off.
4. The MAT credit will not bear any interest.
5. This section has been amended with effect from assessment year 2011-12 to provide that scheme of MAT credit shall not apply to a limited liability partnership which has been converted from private company or unlisted public company.

Practical 7

From the following information, find out the (a) MAT credit to be carried forward before the amendment by Finance Act, 2017 (b) MAT credit to be carried forward after the amendment by Finance Act, 2017.

Particulars	Rs. in Lakhs
Regular Tax Liability (ignoring MAT)	8
MAT Liability	30
Tax Credit under section 90 of the Act	28

Solution**MAT Credit to be carried forward before the amendment by Finance Act, 2017**

Sr. No.	Particulars	Rs. In lakhs
A.	Regular Tax Liability	8
B.	MAT Liability	30
C.	Tax Liability (A or B whichever is higher)	30
D.	Less: Tax credit under section 90 of the Act	(28)
E.	Tax payable	2
F.	MAT Credit to be carried forward (MAT Liability – Regular Tax Liability)	22

MAT Credit to be carried forward after the amendment by Finance Act, 2017

As per the amendment made by Finance Act, 2017, where the amount of tax credit in respect of any income-tax paid in any country or specified territory outside India, under section 90 or section 90A or section 91, allowed against the tax payable under MAT exceeds the amount of such tax credit admissible against the regular tax payable by the assessee, then, while computing the amount of MAT credit, such excess amount shall be ignored.

Sr. No.	Particulars	Rs. In lakhs
A.	MAT Credit to be carried forward before the amendment by Finance Act, 2017 (MAT Liability – Regular Tax Liability)	22
B.	Less: excess credit to be ignored as per Amendment (Refer working note)	(20)
C.	MAT Credit to be c/f after the amendment by Finance Act, 2017 (A-B)	2

Working Note: Excess Credit to be ignored as per the Amendment

Sr. No.	Particulars	Rs. In lakhs
A.	Tax Credit available under section 90 of the Act against the tax payable under MAT (Foreign Tax credit or MAT whichever is lower)	28
B.	Less: Tax Credit available under section 90 of the Act against the regular tax payable (Foreign Tax credit or Regular Tax whichever is lower)	(8)
C.	Excess credit to be ignored as per the amendment	20

Readers Note:

15.3 TAX ON DISTRIBUTED PROFITS OF DOMESTIC COMPANIES POPULARLY KNOWN AS CORPORATE DIVIDEND TAX (CDT)

Section:- 115-O

(A) Levy

Any amount declared, distributed or paid by a domestic company by way of dividend (whether interim or otherwise) out of current or accumulated profits shall be charged to additional income-tax (to be called dividend distribution tax/corporate dividend tax).

This levy is in addition to income tax chargeable on the total income of domestic company.

(B) Rate of dividend distribution tax for all types of dividend except dividend u/s 2(22)(e)

The rate of dividend distribution tax is 15% increased by surcharge (irrespective of amount of dividend) and H.E.C.

(C) Amount on which CDT is payable [For all types of dividend except dividend u/s 2(22)(e)]

Computation of "amount on which CDT is payable" shall be done as under:-

Particulars	Amount (Rs.)
Amount declared, distributed or paid by a domestic company (say holding company) by way of dividend	XXX
Less: (1) The amount of dividend, if any, received during the financial year from domestic subsidiary , <i>where subsidiary has paid the tax under section 115-O</i>	(XXX)
(2) The amount of dividend, if any, received during the financial year from foreign subsidiary , <i>where tax is payable by holding company</i> on such dividend <i>under section 115BBD</i>	(XXX)
(3) The amount of dividend, if any, paid to New Pension System Trust referred to in section 10 (44).	(XXX)
Net distributed profits	XXX
Add: Increase for the purpose of Grossing up of dividend $\left(\text{Net Distributed Profits} \times \frac{15}{100-15} \right)$	XXX
Amount on which Corporate Dividend tax is Payable	XXX

(D) Meaning of subsidiary company for the purpose of this section

A company shall be a subsidiary of another company, if such other company, holds more than half in nominal value of the equity share capital of the company.

(E) Rate of dividend distribution tax for deemed dividend under section 2(22)(e)

The rate of dividend distribution tax is 30% increased by surcharge (irrespective of amount of dividend) and H.E.C. in respect of deemed dividend under section 2(22)(e) i.e. loan or advance given by a closely held company. **(Proviso to section 115-O(1) - inserted by Finance Act, 2018 w.e.f. 01-04-2018)**. Rule of grossing up shall not apply to the dividend under section 2(22)(e). **(Proviso to section 115-O(1B) - inserted by Finance Act, 2018 w.e.f. 01-04-2018)**.

Practical 8

Mr. Chettiar, managing director of Cubic Private Limited, holds 70 percent of its paid up capital. The balance as at March 31, 2018 in general reserve is Rs.6 lakh. The company, during the previous year, has given an interest-free loan Rs.5 lakh to its supervisor having salary of Rs.4,000 per month, who in turn advances the said amount of loan so taken from the company to Mr. Chettiar. Discuss the tax consequences of the above transaction in the hands of Cubic Private Limited and Mr. Chettiar.

Solution**In the hands of Cubic Private Limited**

In the present case, loan is given to supervisor for the benefit of Mr. Chettiar, therefore, such loan (Rs. 5,00,000) is treated as deemed dividend under section 2(22)(e).- **L. Alagusundaram Chettiar v. CIT [2002] 121 Taxman 587 (SC).**

Computation of Corporate Dividend Tax

Particulars	Rs.
CDT on Rs.5,00,000 @30%	1,50,000
Add: Surcharge 12%	18,000
Sub-Total	1,68,000
Add: Health and Education Cess (4%)	6,720
CDT Payable	1,74,720
CDT Payable (Rounded off)	1,74,720

In the hand of Mr. Chettiar

Such dividend shall be exempt in the hands of recipient under section 10(34).

Readers Note:**15.4 CARRY FORWARD AND SET OFF OF LOSSES IN THE CASES OF CERTAIN COMPANIES****Section:- 79 – Effective from A.Y. 2019-20**

In the case of companies in which the public are not substantially interested (other than start-up company referred to in section 80-IAC), loss will not be carried forward and set off unless the shares of the company carrying not less than 51 per cent of the voting power were beneficially held by the same person(s) both on the last day of the previous year in which loss occurred and on the last day of the previous year in which brought forward loss is sought to be set off.

In the case of a company, not being a company in which the public are substantially interested but being an eligible start-up as referred to in section 80-IAC, the loss incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year, if, all the shareholders of such company who held shares carrying voting power on the last day of the year or years in which the loss was incurred,—

- (i) continue to hold those shares on the last day of such previous year; and
- (ii) such loss has been incurred during the period of seven years beginning from the year in which such company is incorporated.

Exceptions - The aforesaid restriction contained in section 79 shall not be applicable if change in voting power takes place in following two cases:

1. Where a change in voting power takes place in a previous year consequent upon the death of a shareholder or on account of transfer of shares by way of gift to any relative of the shareholder making the gift.

2. Where any change in the shareholding of an Indian company which is a subsidiary of a foreign company as a result of amalgamation or demerger of a foreign company subject to the condition that fifty-one per cent shareholders of the amalgamating or demerged foreign company continue to be the shareholders of the amalgamated or the resulting foreign company.
3. **Where a change in the shareholding takes place in a previous year pursuant to a resolution plan approved under the Insolvency and Bankruptcy Code, 2016, after affording a reasonable opportunity of being heard to the jurisdictional Principal Commissioner or Commissioner. [Inserted by Finance Act, 2018, w.e.f A.Y.2019-20]**

Practical 9

Seven Nine Ltd., a closely held company provides the following information.

(1) Brought forward business losses

Previous Year	Amount Rs.
2015-16	(2,00,000)
2016-17	(3,00,000)
2017-18	(1,00,000)

(2) Shareholders and its holding (in percentage) as on the last day of respective previous year.

Previous Years	(%) Shareholding					
	X	Y	Z	A	B	C
2015-16	33	33	34	-	-	-
2016-17	33	33	34	-	-	-
2017-18	33	20	34	-	13	-
2018-19	33	-	-	34*	13	20*

* A change in the shareholding took place in a previous year pursuant to a resolution plan approved under the Insolvency and Bankruptcy Code, 2016, after affording a reasonable opportunity of being heard to the jurisdictional Principal Commissioner or Commissioner.

You are required to calculate total income for the previous year 2018-19 assuming that income under the head "PGBP" before set off is Rs. 9,00,000.

16 - ALTERNATIVE MINIMUM TAX [CHAPTER XII-BA]**16.1 | SPECIAL PROVISIONS FOR PAYMENT OF TAX BY CERTAIN PERSONS OTHER THAN A COMPANY. – CONCESSIONAL TAX RATE PROVIDED FOR UNIT IN IFSC****Section:-** 115JC, CHAPTER- XII BA – Effective from A.Y.2019-20**(A) Sub-Section (1)**

Where the *regular income-tax payable* for a previous year by a person, other than a company, is less than the *alternate minimum tax payable* for such previous year, the *adjusted total income* shall be deemed to be the *total income* of that person for such previous year and he shall be liable to pay income-tax on such total income at the rate of *eighteen and one-half percent*.

(B) Sub-Section (2)

Adjusted total income shall be the *total income* before giving effect to this Chapter as increased by—

- (i) *deductions claimed*, if any, under any section (other than section 80P) included in Chapter VI-A under the heading "C.—Deductions in respect of certain incomes"; and
- (ii) *deduction claimed*, if any, under section 10AA; and
- (iii) *deduction claimed*, if any, under section 35AD as reduced by the amount of depreciation allowable in accordance with the provisions of section 32 as if no deduction under section 35AD was allowed in respect of the assets on which the deduction under that section is claimed.

(C) Sub-Section (3)

Every person to whom this section applies shall obtain a report, in prescribed form, from an accountant, certifying that the adjusted total income and the alternate minimum tax have been computed in accordance with the provisions of this Chapter and furnish such report on or before the due date of furnishing of return of income under section 139(1).

(D) Sub-Section (4)

Notwithstanding anything contained in sub-section (1), where the person referred to therein, is a unit located in an International Financial Services Centre and derives its income solely in convertible foreign exchange, the provisions of sub-section (1) shall have effect as if for the words "eighteen and one-half per cent", the words "nine per cent" had been substituted. [Inserted by Finance Act, 2018 w.e.f A.Y. 2019-20].

16.2 | INTERPRETATION IN THIS CHAPTER**Section:-** 115JF – Effective from A.Y.2019-20

In this Chapter—

- (a) "accountant" shall have the same meaning as in the Explanation below sub-section (2) of section 288;
- (b) "alternate minimum tax" means the amount of tax computed on adjusted total income,—
 - (i) in case of an assessee being a unit referred to in sub-section (4) of section 115JC, at a rate of nine per cent;
 - (ii) **in any other case, at a rate of eighteen and one-half per cent; [Amended made by Finance Act, 2018, w.e.f. A.Y. 2019-20]**

- (c) "convertible foreign exchange" means a foreign exchange which is for the time being treated by the Reserve Bank of India as convertible foreign exchange for the purpose of the Foreign Exchange Management Act, 1999 (42 of 1999) and the rules made thereunder; [Inserted by Finance Act, 2018, w.e.f. A.Y. 2019-20]
- (d) "International Financial Services Centre" shall have the meaning assigned to it in clause (q) of section 2 of the Special Economic Zones Act, 2005 (28 of 2005); [Inserted by Finance Act, 2018, w.e.f. A.Y. 2019-20].
- (e) "regular income-tax" means the income-tax payable for a previous year by a person on his total income in accordance with the provisions of this Act other than the provisions of this Chapter
- (f) "unit" means a unit established in an International Financial Services Centre. [Inserted by Finance Act, 2018, w.e.f. A.Y. 2019-20]

Practical 1

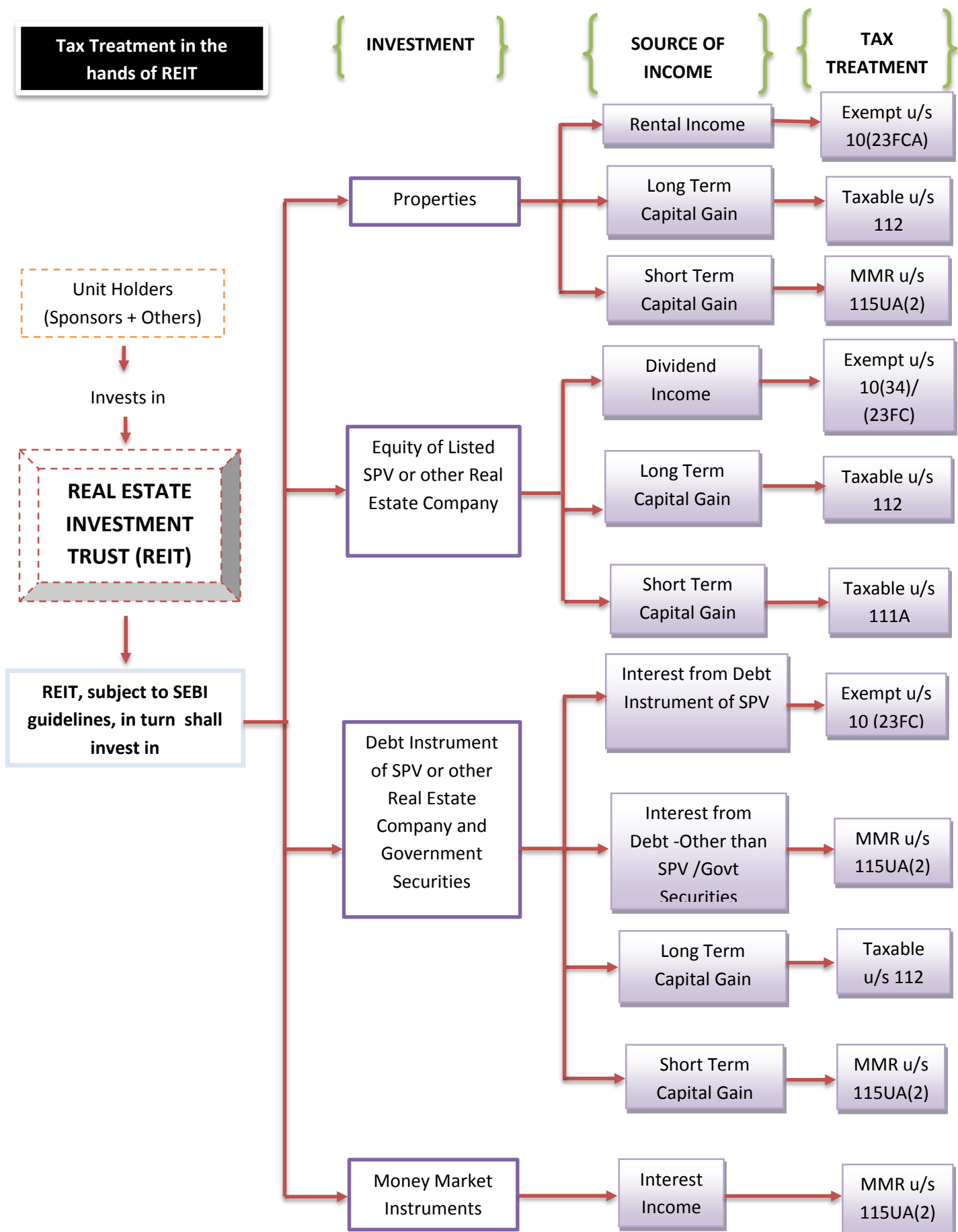
Ding Dong LLP is a unit located in International Financial Service and derives its income solely in convertible foreign exchange. For the relevant previous year, it earned following incomes:

Sr. No.	Particulars	Rs.
(1)	Income under the head PGBP (Eligible for deduction u/s 10AA- ET/TT 90%)	22,20,000
(2)	Income from other sources	1,30,000
(3)	Contribution to Prime Minister National Relief Fund by cheque	10,000

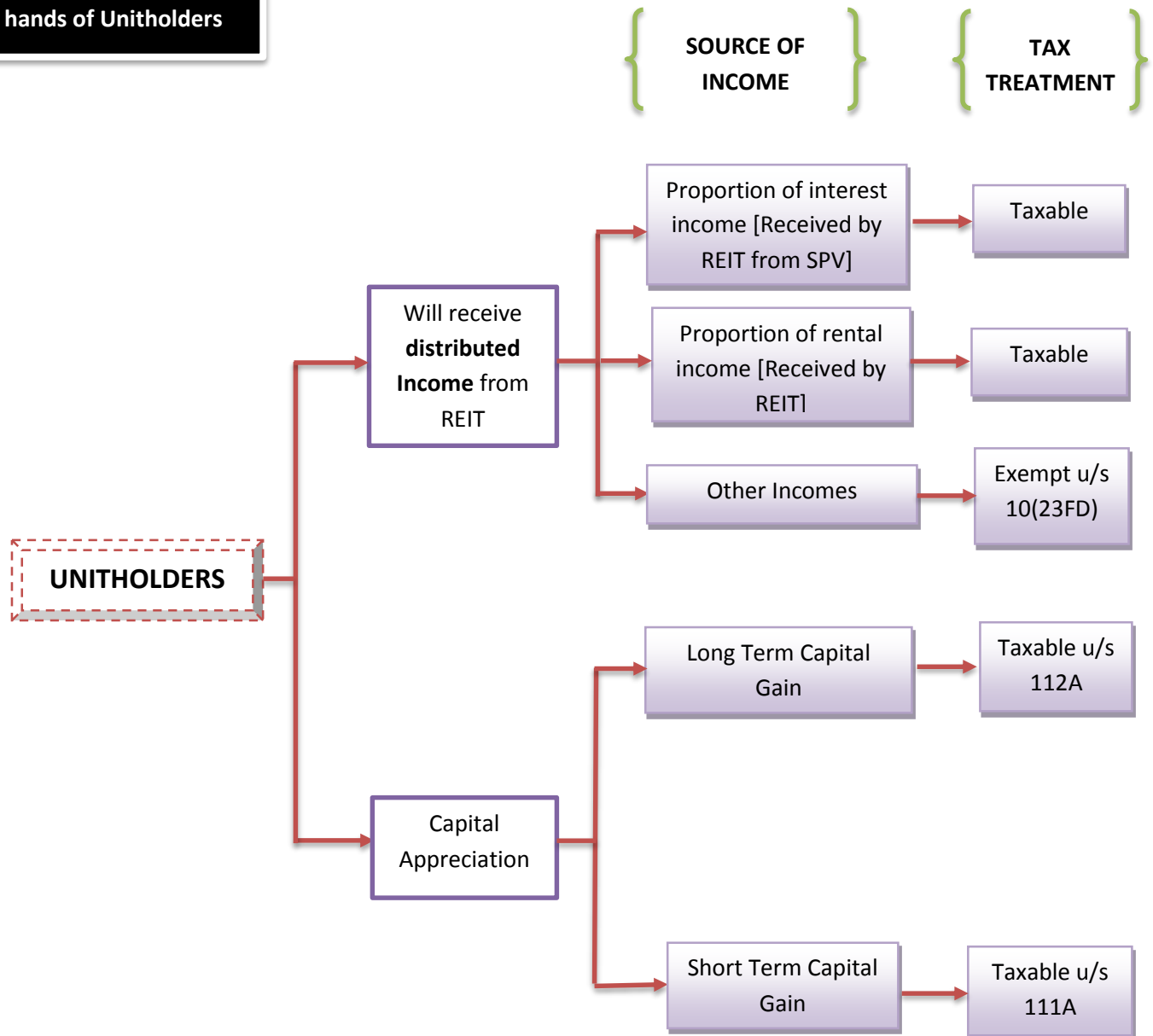
You are required to compute tax liability.

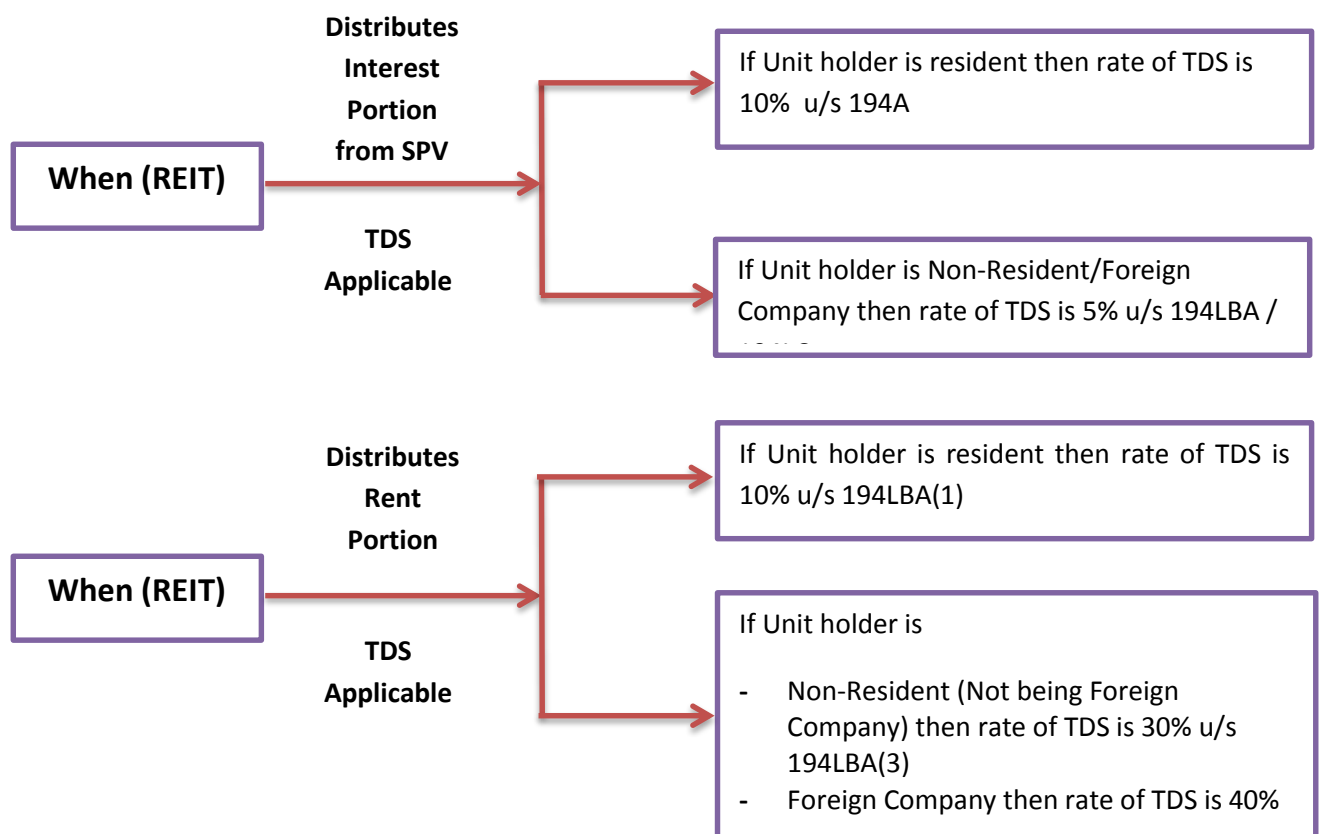
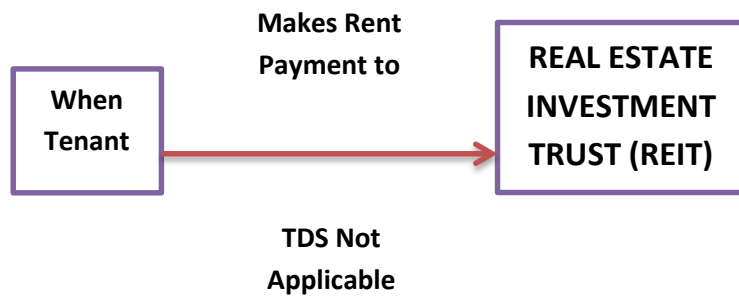
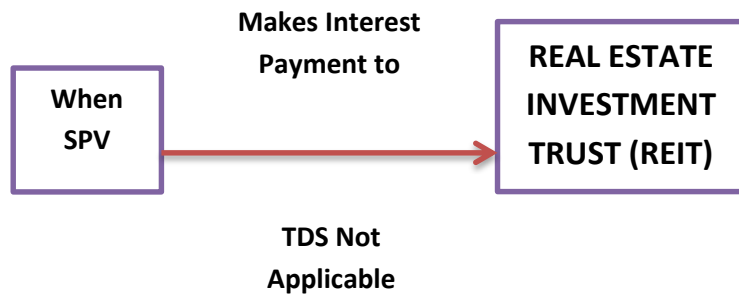
17 - ASSESSMENT OF HINDU UNDIVIDED FAMILY [HUF]

18 - BUSINESS TRUST



Tax treatment in the hands of Unitholders

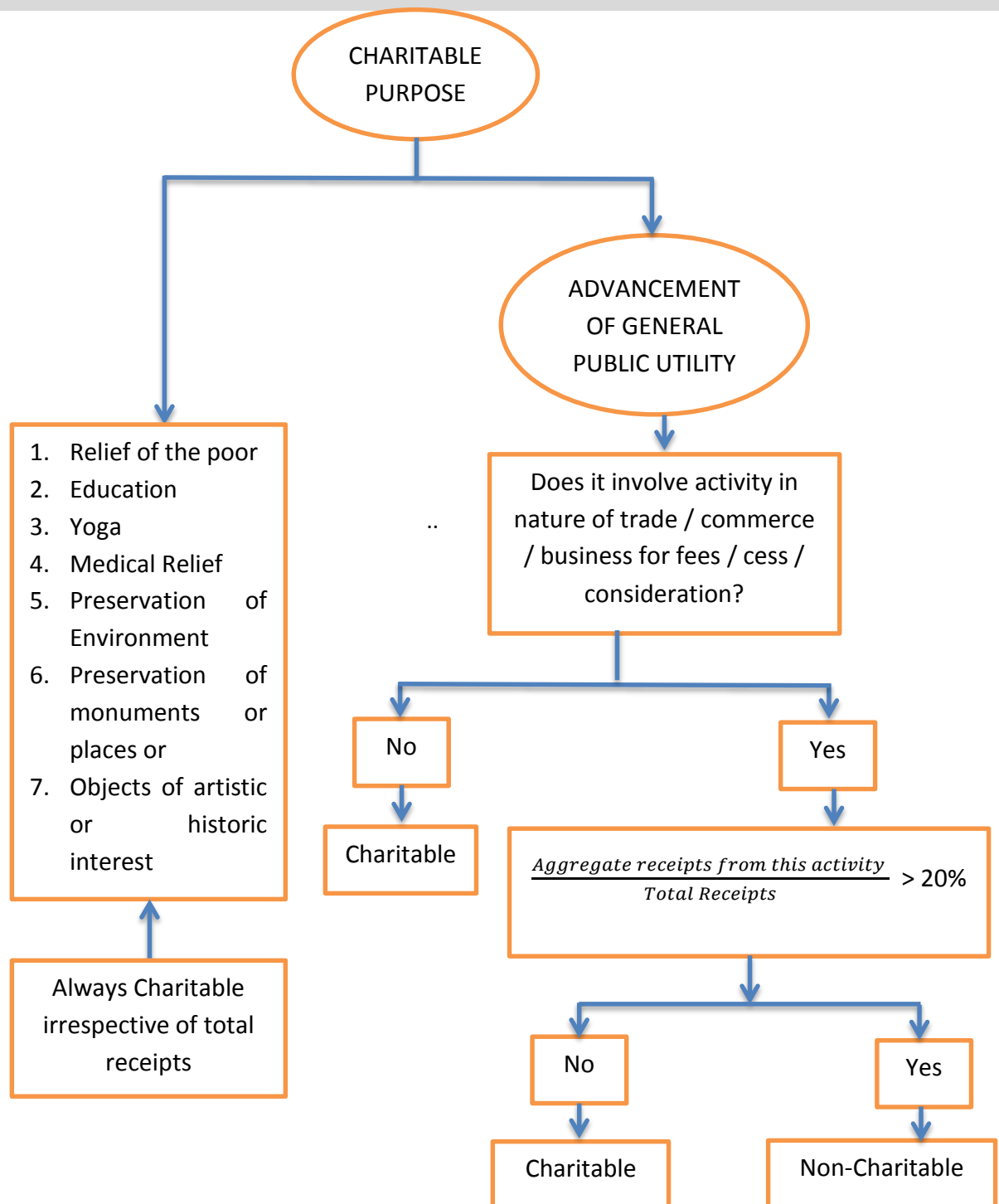




19 - TAXATION OF TRUSTS OR INSTITUTIONS

19.1 CHARITABLE PURPOSE

Section:- 2(15)



19.2 CONDITIONS FOR CLAIMING EXEMPTION

Section:- 12A(1)

The income derived from property held under trust wholly for charitable or religious purposes is exempt from tax under section 11 subject to fulfillment of certain conditions.

The conditions are:

- (i) The trust or institution shall be registered under section 12AA.

- (ii) In a case, trust or institution has been granted registration under section 12AA, and, subsequently, it has adopted or undertaken modifications of the objects which do not conform to the conditions of registration, then it shall be required to make an application, in the prescribed form and manner, within a period of thirty days from the date of said adoption or modification, to the Principal Commissioner or Commissioner and thereupon obtain fresh registration. **(Inserted by Finance Act, 2017 w.e.f. assessment year 2018-9)**
- (iii) The accounts of the trust or institution for the previous year shall be audited if the total income before claiming exemption under section 11 and 12 exceeds exemption limit.
- (iv) Trust or institution has furnished the return in accordance with the provisions of Section 139(4A), within the time allowed under that section. Referring the same, the conclusion is that the trust or institution shall furnish the return of income within the time limit given under section 139(1) of the Act. **(Inserted by Finance Act, 2017 w.e.f. assessment year 2018-19)**

19.3 EXEMPTION TO THE CHARITABLE TRUST OR INSTITUTION

Section:- 11

Para No.	Section	Particulars
19.3A	11(1)	Exemption based on application of income
19.3B	11(2),11(3)&11(5)	Exemption based on accumulation of income
19.3C	11(1A)	Exemption on transfer of capital asset
19.3D	11(4), (4A)	Exemption in respect of income from business undertaking held by trust
19.3E	11(6)	Restriction on allowability of depreciation or deduction of asset in certain circumstances
19.3F	11(7)	Restriction on claiming benefit of exemption under various clauses of section 10 of the Act

19.3A EXEMPTION BASED ON APPLICATION OF INCOME

Section :- 11(1) and Explanation 1 to 3 to section 11(1)

- Section 11(1) provides that if income of charitable or religious trust has been applied for the objects in India, then amount set apart or accumulated upto 15% of income shall not be included in total income of the trust. (The outcome of the exemption is that trust shall apply remaining 85% of its income for the objects of trust.)
- Thus, exemption under section 11 is 15 per cent of income derived from property held under charitable purpose without being spent—*CIT v. Programme for Community Organisation [2001] 116 Taxman 608 (SC)*.
- Critical Provisions / Judicial pronouncements / Circulars relevant for computation of income of the charitable trust or institution.**
 - Voluntary contributions (donations) received by a trust are treated as income - **Explanation to section 11 (1)**
 - Corpus donations received by a trust are not treated as income. For this purpose, corpus donations means the donations received with a specific direction from the donor that they shall form part of corpus of the trust.- **Section 12**
 - It would be incorrect to assign to the word “income” used in section 11(1) (a), the same meaning as has been specifically assigned to the expression “total income” vide section 2(45).– **Circular no. 5-P(LXX-6) of 1968, dated 19-6-1968.**

- (d) Considering the language of section 11(1)(a), concept of classifying the incomes of trust under different heads of income have no relevance. Not only that trust is not entitled for statutory deductions under section 80 C to 80 U.- **Director of Income Tax Vs. Girdharilal Shewanarain Tantia Trust (1993) 199 ITR 215 (Cal).**
- (e) Income has to be understood in the popular or general sense. Therefore, while measuring the income of the trust for the purpose of section 11, deduction in respect of expenditure incurred for earning income and depreciation debited to profit and loss account has to be given- **CIT v. Seth Manilal Ranchhoddas Vishram Bhavan Trust [1992] 105 CTR (Guj.) 303**
- (f) The trust is entitled to set off the amount of excess application of the last year against the deficiency of the current year —**CIT v. Matriseva Trust [2000] 242 ITR 20 (Mad.).**
- (g) In case of **S. RM. M. CT. M. Tiruppani Trust vs. CIT [1998] 96 Taxman 635 (SC)**, trust has applied Rs. 8,00,000 for charitable purposes in India by purchasing a building which is to be utilized as a hospital. This was allowed as application of income for the purpose of section 11(1). That means, application of income under section 11(1) can be either towards revenue expenditure or capital expenditure provided the same shall be for the objects of the trust.
- (h) Donation of income to another charitable trust is also treated as application of income for the purpose of s. 11(1) - **CIT v. Sarladevi Sarabhai Trust (No. 2) [1988] 172 ITR 698 (Guj.)**
However, with effect from Assessment Year 2018-19, any donation (contribution) given to a trust or institution with a specific direction that they shall form part of the corpus of recipient trust or institution, then it shall not be treated as application of income for the donor trust or institution. - Vide explanation 2 to section 11(1). [Amendment by Finance Act, 2017]
- (i) Repayment of loans originally taken to fulfill one of the objects of trust is treated as an application of income for charitable purposes.-Vide circular No. 100, 24-01-1973 and **CIT v. Janmabhoomi Press Trust [2000] 242 ITR 703 (Kar.).**
- (j) **In case of CIT v. Trustees of H.E.H The Nizam's Charitable Trust [1981] 131 ITR 497 (AP)**, the high court observed the facts of the case and held as under:
 "From the facts it is clear that the donees concerned make a request for a grant from the trust and the trustees after considering the request, sanction certain amounts in deserving cases. As soon as the resolution is passed, the secretary informs the institution that such and such amounts have been sanctioned by the trustees at a meeting held on a particular date and also intimates the purposes for which they are sanctioned. In cases where the amounts are not disbursed during the accounting year, the amounts are debited to the income and expenditure account and credited to the outstanding payment account, which contains the amount due to the various donees as per the resolutions passed by the board. When the payment is made, this amount is debited. The amounts debited to the income and expenditure account but which are not actually disbursed are shown as liabilities in the balance-sheet. These facts and circumstances would constitute application of the funds for charitable purposes within the meaning of s. 11(1)(a). It is not correct to equate the word "applied" with the word "spent".
- (k) For the purposes of determining the amount of application under section 11(1)(a)/(b), the provisions of section 40(a)(ia) and sections 40(3)/(3A), shall, mutatis mutandis, apply as they apply in computing the income chargeable under the head "Profits and gains of business or profession" - **Explanation 3 to section 11(1)–Inserted by Finance Act, 2018 w.e.f. A.Y.2019-20**

- **Tax treatment, if in any previous year, the income applied to the objects of the trust falls short of 85% of the income derived during that year. There may be two possibilities for deficiency in application upto 85% of the income. They are:-**

Possibility 1

If shortfall is due to the reason that the whole or any part of the **income** has **not been received** during that year, then such income can be applied during the previous year in which the income is received or in the immediately following previous year.

The option to apply the income in the other year as mentioned above shall be exercised before the expiry of the time allowed u/s.139 (1) for furnishing the return of income.

Possibility 2

If shortfall is due to any other reason, then such income can be applied during the previous year immediately following the previous year in which the income was derived.

The option to apply the income in the other year as mentioned above shall be exercised before the expiry of the time allowed u/s.139 (1) for furnishing the return of income.

19.3B | EXEMPTION BASED ON ACCUMULATION OF INCOME

Section:- 11(2), 11(3) and 11(5)

- 1) Where 85 per cent of income is not applied to charitable or religious purposes, the trust can accumulate or set apart its income for a specified purpose by informing the concerned Assessing Officer.
- 2) Such income so accumulated or set apart will not be included in the total income of the trust or institution in the year of receipt of income, provided such trust or institution furnishes a statement in the prescribe form [At present, Form no. 10] and in the prescribed manner to the Assessing Officer, the purposes and period for which the income is accumulated or set apart.
- 3) However the period for which the funds can be accumulated shall not exceed 5 years.
- 4) In computing the period of five years, the period during which the income could not be applied for the purpose for which it is so accumulated or set apart, due to an order or injunction of any court, shall be excluded.
- 5) Further, the money so set apart or accumulated should be invested/ deposited in any one or more of modes or forms specified in section 11(5).
- 6) The prescribed form [At present, Form No. 10] shall be furnished before the expiry of time allowed under section 139(1).
- 7) *Consequences in case of default:*
 - a. If in any year the income which is accumulated for the specified purpose or purposes of the trust is applied to the purposes other than charitable or religious purposes or ceases to be accumulated or set apart for application to such purposes, it will become chargeable to tax as the income of that year.
 - b. If in any year, the accumulations cease to remain invested in any of the forms or modes specified in section 11(5) then also the income so accumulated will become chargeable to tax as the income of that year.
 - c. If the income accumulated is not utilised for the specified purpose during the specified period or in the immediately following year, it will be deemed to be the income of the trust for the previous year immediately following the expiry of the specified period.
 - d. If in any year, the accumulated income is credited or paid to any trust or institution registered under section 12AA or to any fund or institution or any university or educational institutions or any hospital or

other medical institutions referred to in section 10(23C) then income so credited or paid will become chargeable to tax as the income of that year.

- 8) If the trust is unable to apply the accumulated funds for the purpose for which it was accumulated due to circumstances beyond control, the Assessing Officer may allow the application of such funds for other charitable or religious purpose requested for by the assessee in conformity with the objects of the trust.
- 9) However, in cases where the trust or institution is dissolved, the Assessing Officer may allow application of such accumulated income towards contribution to other trusts or institutions registered u/s. 12AA or to any fund or institution or any university or educational institution or any hospital or other medical institution referred u/s. 10(23C) in the year in which such dissolution takes place.
- 10) As per section 11(5), the funds of a charitable trust or institution which got accumulated under section 11(2) shall be invested or deposited in the prescribed modes.

Practical 1

Gangaram Public Charitable Trust runs a hospital. The gross receipts from its operational activities is Rs. 250 Lacs and expenses incurred are Rs. 55.20 Lacs. Out of expenses of Rs.55.20 lakhs, Rs.20,000 was incurred in respect of repairing work done, the payment of which was made in cash to the labour contractor. Depreciation on various assets used in the hospital is Rs. 15 Lacs. Out of income of Rs. 250 Lacs, the amount accrued but not received during the previous year is Rs. 20 Lacs. The institution earmarked and set apart Rs. 30 Lacs in the month of March to give as advance for a building intended to be taken on lease for expansion of the hospital, but the amount was paid on 7th April of next year, as the lease agreement could not be signed by 31st March of the previous year. The trust has got an ERP package developed and installed by an IT company during the year. The total cost to the trust on account of the ERP package was Rs. 85 Lacs. Advice the trust on its total income, if the trust has incurred Rs. 12 Lacs for purchase of a number of desktop and laptop computers for use in the hospital.

Solution

Computation of total income of trust

Particulars	Rs. in lakhs
Income derived from property held under trust	250
Less: Expenses incurred in earning income [Note 4]	(55)
Less: Depreciation on used assets	(15)
Business Income	180
Less: 15% to be set apart (15% of Rs.180)	(27)
Balance	153
Less: Income not received during the year [Note 3]	(20)
	133
Less: Non-application of income resulting from non-signing lease agreement[Note 1]	(30)
Available amount	103
Less: Development and installation expenses of ERP package [Note 2]	(85)
Less: Purchase of desktop and laptop computers [Note 2]	(12)
Taxable income	6

Notes:

1. In **CIT v. Trustees of H.E.H The Nizam's Charitable Trust [1981] 131 ITR 497 (AP)**, it was held that in order to secure exemption under section 11, it is sufficient if the assessee provides or sets apart the funds for a

charitable purpose and it is not necessary that the assessee must have spent the amount during the relevant assessment year.

2. In **S.R.M.M.C.T.M. Tirupaani Trust v. CIT [1998] 230 ITR 636 (SC)**, it was held that for the purpose of claiming exemption u/s 11, a trust can apply its income either on capital expenditure or on revenue expenditure.
3. Income not received during the current year may be spent in the year of receipt or in the immediately following year. For this purpose, the option has to be exercised in writing before the expiry of due date of submission of return of income.
4. In view of the explanation 3 to section 11(1), Rs. 20,000 shall not allowed as deduction while computing income of the trust.

Reader's Note:

Practical 2

A Charitable Public Trust provides following information:

- (a) It received voluntary contribution of Rs.20,00,000 during the previous year.
- (b) It also received contribution of Rs.5,00,000 with a specific direction that it shall form part of corpus of the trust.
- (c) It accumulates Rs.7,00,000 for purchase of five Ambulances and informed the Assessing Officer accordingly.
- (d) It spent Rs.2,30,000 for the objects of the Trust. The break-up of which is as under:
 - Rs. 22,000 cash payment for purchase of medicines on a single day.
 - Rs. 1,08,000 paid to visiting doctor by an account payee cheque but failed to deduct tax at source.
 - Rs. 1,00,000 rent, taxes, electricity and other office expenses by an account payee cheque
- (e) It also donated Rs. 40,000 was to PQR charitable trust having similar objects but payment was made by bearer cheque.
- (f) Another Rs. 20,000 was donated to XYZ charitable trust (by an account payee cheque) with a direction that it will form part of corpus of XYZ charitable trust.

Determine total income of the trust.

19.3C | EXEMPTION ON TRANSFER OF ASSET

Section:- 11(1A)

- (a) where a capital asset, being property held under trust wholly for charitable or religious purposes, is transferred and the whole or any part of the net consideration is utilised for acquiring another capital asset to be so held, then, the capital gain arising from the transfer shall be deemed to have been applied to charitable or religious purposes to the extent specified hereunder, namely:—
 - (i) where the whole of the net consideration is utilised in acquiring the new capital asset, the whole of such capital gain;
 - (ii) where only a part of the net consideration is utilised for acquiring the new capital asset, so much of such capital gain as is equal to the amount, if any, by which the amount so utilised exceeds the cost of the transferred asset;

In nutshell, the amount deemed to be utilized for the objects of the trust for clause (ii) above =
 [Amount utilized in acquiring the new capital asset – cost of transferred asset.]

- (b) where a capital asset, being property held under trust in part only for such purposes, is transferred and the whole or any part of the net consideration is utilised for acquiring another capital asset to be so held, then, the appropriate fraction of the capital gain arising from the transfer shall be deemed to have been applied to charitable or religious purposes to the extent specified hereunder, namely:—
- (i) where the whole of the net consideration is utilised in acquiring the new capital asset, the whole of the appropriate fraction of such capital gain;
 - (ii) in any other case, so much of the appropriate fraction of the capital gain as is equal to the amount, if any, by which the appropriate fraction of the amount utilised for acquiring the new asset exceeds the appropriate fraction of the cost of the transferred asset.

The “appropriate fraction” in this context means the fraction obtained by dividing the amount of the income which, under the terms of the trust, is applicable to charitable or religious purposes, by the whole of the income derived from property held under trust in part only for such purposes.

Remarks:

- (a) Investment in fixed deposit of a bank is considered as acquisition of a capital asset for the purpose of section 11(1A) - **Hindustan Welfare Trust 206 ITR 138 (Cal)**.
- (b) Acquisition of English Mortgage is regarded as acquisition of capital asset for the purpose of section 11(1A).- **Bafna Charitable Trust V. CIT (1998) 230 ITR 864.**

Practical 3

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.

Particulars	Rs.
Cost of transferred asset	2,40,000
Sale consideration	3,80,000
Cost of new asset purchased	3,00,000
Expenses in connection with transfer	20,000

Solution

As discussed above u/s 11(1A), the amount deemed to be utilized for the objects of the trust

= Amount utilized in acquiring the new capital asset – cost of transferred asset.

=Rs. 3,00,000 less Rs. 240,000

=Rs. 60,000

Reader's Note:

Practical 4

Suppose in the above problem, capital asset utilized for the purposes of the trust in part and the appropriate fraction is 60%, what shall be the amount of capital gain which shall be deemed to have been applied for the objects of the trust.

Solution

In the given case, appropriate fraction is 60%, therefore, the amount of capital gain deemed to be utilized for the object of trust is 60% of Rs.60,000= Rs.36,000.

Reader's Note:

19.3D | EXEMPTION IN RESPECT OF INCOME FROM BUSINESS UNDERTAKING HELD BY A TRUST**Section:-** 11(4) and 11(4A)**(A) A business undertaking held by a trust shall be treated as a “property held under a trust”. [Section 11(4)]**

Where a claim is made that the income of any business shall not be included in the total income, the Assessing Officer shall have power to determine the income of such undertaking in accordance with the provisions of the Act relating to assessment. Where any income so determined is in excess of the income as shown in the accounts of the undertaking, such excess shall be deemed to be applied to purposes other than charitable or religious purposes.

(B) Section 11(4A)

In the case of a trust or institution, income from business shall be eligible for exemption under section 11(1) or 11(2) subject to following conditions–

- (a) The business is incidental to the attainment of the objects of the trust or institution.
- (b) Separate books of accounts are maintained in respect of such business.

19.3E | RESTRICTION ON ALLOWABILITY OF DEPRECIATION OR DEDUCTION OF ASSET IN CERTAIN CIRCUMSTANCES–**Section:-** 11(6)

This section provides that while determining total income of the trust, no depreciation or deduction shall be allowed in respect of an asset, cost of which has been claimed as an application of income, in the same or any other previous year.

19.3F | RESTRICTION ON CLAIMING BENEFIT OF EXEMPTION UNDER VARIOUS CLAUSES OF SECTION 10 OF THE ACT**Section:-** 11(7)

This section provides that trust or institution registered under section 12AA can claim only following exemptions under section 10.

- (i) Section 10(1) : Exemption in relation to agricultural income
- (ii) Section 10(23C): Exemption to certain national funds, educational institutions and hospitals.

Therefore, reader shall strictly note that *trust or institution cannot straightaway exclude following incomes while computing total income* because such incomes are not covered by section 10(1) or 10(23C):-

Section 10(34)	: Dividend Income
Section 10(33)	: Capital gain on transfer of unit of US 64
Section 10(34A)	: Capital gain on Buy Back of unlisted shares
And many more	: As covered by section 10 of the Income Tax Act, 1961

Practical 5

During previous year, a public charitable trust registered under section 12AA of I.T. Act, derived gross income of Rs. 26 lakhs, which consists of the following:

Sr. No.	Particulars	Amount (Rs.)
1.	Income from properties held under trust	9,00,000
2.	Voluntary contributions from public	7,00,000
3.	Corpus donations	4,00,000

4.	Dividend income from shares of Indian Companies	1,00,000
5.	LTCG on buy back of unlisted shares	3,00,000
6.	Income from agriculture operations	2,00,000

During the previous year under consideration, the trust had spent Rs. 11,60,000 towards charitable purposes. Further, trust has purchased small office on the beginning of the previous year for Rs. 5,00,000. (Rate of depreciation is 10%). Determine the taxable income of the trust.

Solution

In this practical aspect, trust has purchased small office. Therefore, trust has two options:

Option 1: To claim investment in office as application of income and therefore, cannot claim depreciation in view of section 11(6)

Option 2: Not to claim investment in office as application of income and to avail depreciation in respect of such office.

Considering the above two options, answer is as under:

Option 1

Particulars	Rs.
Income from property held under trust	9,00,000
Add: Voluntary Contribution received from public	7,00,000
Add: Corpus Donations are not an income	Nil
Add: Dividend income from shares (Exemption u/s 10(34) not available)	1,00,000
Add: LTCG on buy back of unlisted shares (Exemption u/s 10(34A) not available)	3,00,000
Add: Income from Agricultural Operations(Exemption u/s 10(1) is available to trust)	Nil
	20,00,000
Less: 15% Set apart	(3,00,000)
Balance	17,00,000
Less: Applied for the objects of Trust	(11,60,000)
Less: Applied for purchase of Office	(5,00,000)
Total Income	40,000

Option 2

Particulars	Rs.
Income from property held under trust	9,00,000
Add: Voluntary Contribution received from public	7,00,000
Add: Corpus Donations are not an income	Nil
Add: Dividend income from shares (Exemption u/s 10(34) not available)	1,00,000
Add: LTCG on buy back of unlisted shares (Exemption u/s 10(34A) not available)	3,00,000
Add: Income from Agricultural Operations(Exemption u/s 10(1) is available to trust)	Nil
	20,00,000
Less: Depreciation in respect of Office [10% of Rs.5,00,000]	(50,000)
	19,50,000
Less: 15% Set apart	(2,92,500)
Balance	16,57,500
Less: Applied for the objects of Trust	(11,60,000)
Total Income	4,97,500

Reader's Note:

19.4 CASES WHEN INCOME SHALL NOT BE EXEMPT U/S. 11 OR 12**Section:- 13**

The benefit of section 11 or 12 shall not be available in following cases.

Section	Particulars
13(1)(a)	Income for private religious purposes
13(1)(b)	Income for the benefit of particular religious community
13(1)(c), 13(2) and 13(3)	Enuring benefit to specified persons:
13(1)(d)	Investment/deposit not in accordance with section 11(5)
13(7)	Anonymous donation
13(8)	“Advancement of general public utility” ceases to be charitable purpose.
13(9)	Benefit of accumulation under section 11(2) shall not be available under certain circumstances.

19.5 CANCELLATION OF REGISTRATION**Section:- 12AA(3) and 12AA(4)****(A) Cancellation of registration under Section 12AA (3)**

Where a Trust or an Institution has been granted registration and subsequently the Commissioner is satisfied that the activities of such trust or Institution are not genuine or in contravention of the objects, then the Commissioner has the power to pass an order in writing canceling the registration after giving a reasonable opportunity of being heard.

(B) Cancellation of registration under Section 12AA (4)

Without prejudice to the provisions of sub-section (3), where a trust or an institution has been granted registration under section 12AA/ 12A and subsequently it is noticed that the activities of the trust or the institution are being carried out in a manner that the provisions of sections 11 and 12 do not apply due to operation of sub-section (1) of section 13, then, the Principal Commissioner or the Commissioner may by an order in writing cancel the registration of such trust or institution.

Provided that the registration shall not be cancelled under this sub-section, if the trust or institution proves that there was a reasonable cause for the activities to be carried out in the said manner.

Practical 6

Ram-Lakhan Charitable trust is a registered trust under Income Tax Act. During the course of assessment proceedings for the relevant assessment year, the assessing officer found that activities of trust are genuine and not in contravention of the objects of trust but made following observations:

- (i) Remuneration paid to trustees is more than what shall be reasonably paid for such services.
- (ii) Property of the trust was made available to trustee without charging rent.

As a result, the assessing officer had given show cause notice that why exemption of trust shall not be withdrawn applying section 13(1)(c) and why trust shall not be taxed at maximum marginal rate? Trustees of the trust failed to give explanation and therefore, assessing officer forfeited exemption of trust while passing order under section 143(3).

Based on the above assessment order, Commissioner issued notice to Ram Lakhan Charitable trust that why registration of trust shall not be cancelled?

The contention of trustees was that the activities carried out by the trust are genuine and same fact has also been noted by the assessing officer while passing order under section 143(3), therefore in view of provisions of section 12AA(3), Commissioner is not justified in cancelling registration of trust.

Examine the validity of stand taken by trustees

Solution

On reading section 12AA(3), Commissioner has power to cancel registration only if activities of trust are not genuine or in contravention of the objects but with effect from 1st October, 2014, Commissioner is empowered to cancel registration of trust under section 12AA(4) if activities of trust are carried out in a manner that exemption under section 11 is not available in view of section 13(1) of the Act.

In the present case, assessing officer forfeited exemption under section 11 applying section 13(1)(c) because remuneration paid to trustees was unreasonable and property of trust is made available without charging adequate rent. And therefore, considering the provisions of section 12AA(4), Commissioner is justified in cancelling registration of trust.

Hence, the contention raised by trustees does not find legal support but trustees, alternatively, may plea to CIT that there was a reasonable cause for paying higher remuneration or making property available without charging rent

Reader's Note:**Practical 7**

A Trust has an object of “advancement of general public utility” and registered under the Income Tax Act for last 5 years. During the relevant previous year, ratio of receipts from this activity to total receipts exceeded 20%. Trust seeks your advice on following issues:

- Can Commissioner of Income Tax cancel the registration of trust on the ground that the object of the trust is no more charitable?
- Can trust claim exemption under section 11 for the year under consideration?

Solution

- In view of **CBDT circular No. 21/2016 dated 27th May, 2016**, it would not be mandatory to cancel registration unless such cancellation becomes necessary on the other grounds prescribed under the Act.
- Considering the provisions of section 13(8) as well as the clarification given in the above-mentioned circular, trust cannot claim exemption under section 11 for the year under consideration.

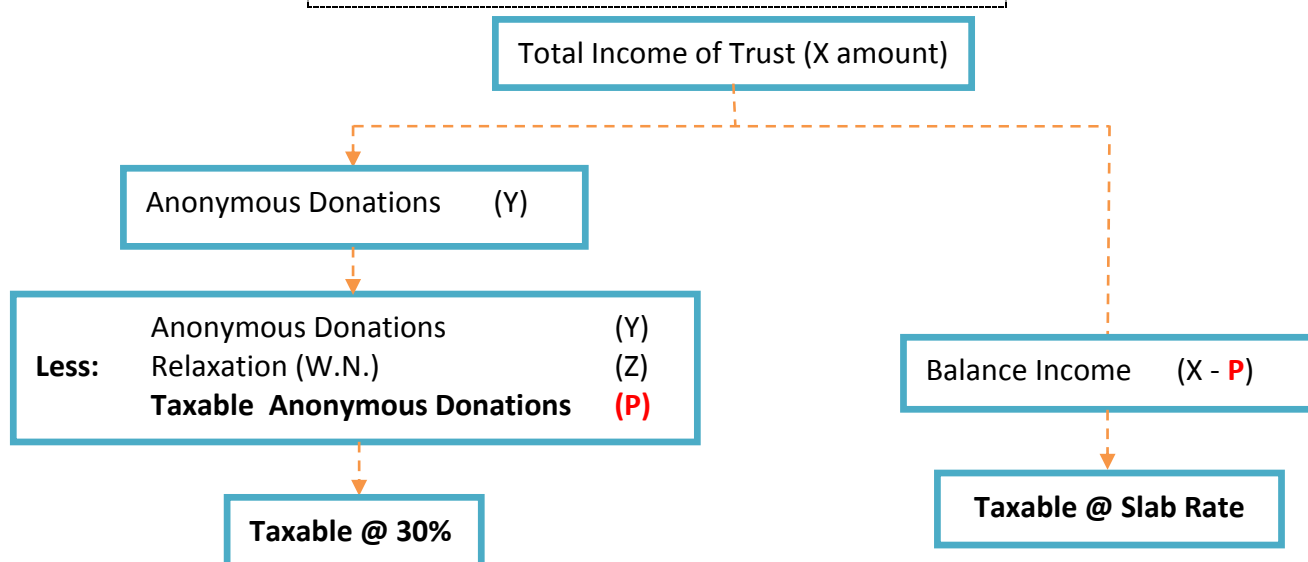
Reader's Note:**19.6 TAX RATES APPLICABLE TO CHARITABLE OR RELIGIOUS TRUST****Section:- 164(2)**

Particulars	Tax Treatment
Income of Public Charitable Trust / Religious Trust after claiming Exemption under Section 11	Taxable as an AOP (i.e. slab rates)
If exemption is forfeited due to contravention u/s. 13(1) (c) or 13(1)(d)	Such income is taxable at maximum marginal rate.

Judicial Rulings A trust will attract the maximum marginal rate of tax only that part of income which has forfeited exemption under section 13 (1) (c) or 13 (1) (d) and not on the entire income. –**Director of Income-tax (Exemption) v. Sheth Mafatlal Gagalbhai Foundation Trust (2001) 114 Taxmann 19 (Bom.)**

19.7 TAXABILITY OF ANONYMOUS DONATIONS**Section:- 115BBC**

Sr. No.	Institution receiving anonymous donations	Tax Treatment
1.	Wholly religious entities	Section 115BBC is not applicable
2.	Partly religious and partly charitable entities	If anonymous donation is made to an educational or medical institution run by such an entity, such anonymous donation is taxable at the rate of 30 per cent. Any other anonymous donation is not subject to tax.
3.	Wholly charitable entities	All anonymous donations are taxed at the rate of 30 per cent under section 115BBC.

Computation Methodology under section 115BBC**Working Note:**

Relaxation given under section 115BBC shall be higher of the followings

- (a) 5% of TOTAL DONATIONS
- (b) Rs. 1,00,000

20 - RETURNS, ASSESSMENT, REASSESSMENT AND RECTIFICATION**20.1 RETURN OF INCOME****Section:- 139(1)**

- (i) Every company shall furnish return of income in respect of its income or loss for every previous year.
- (ii) Every firm shall furnish return of income in respect of its income or loss for every previous year.
- (iii) Every other person, whose total income or total income of any other person in respect of which he is assessable exceeds the maximum amount not chargeable to tax, shall furnish a return of income. [For this proviso, total income = Total income without giving effect to the provisions of sections 10A, 10(38) and sections 80C to 80U]
- (iv) Every resident person shall mandatorily furnish return of income or loss if he or it at any time during the previous year-
 - (a) holds, as a beneficial owner or otherwise, any asset (including any financial interest in any entity) located outside India or has signing authority in any account located outside India; or
 - (b) is a beneficiary of any asset (including any financial interest in any entity) located outside India.

Exceptions:

1. This clause is not applicable to resident but not ordinary resident
 2. This clause is also not applicable to an individual, being a beneficiary of any asset (including any financial interest in any entity) located outside India where, income, if any, arising from such asset is includible in the income of the person referred to in clause (a) above.
- (v) The return of income shall be filed in the prescribed form containing prescribed particulars within the prescribed time.

Practical 1

State whether the following persons have to mandatorily furnish their return of income for the relevant assessment year.

- (a) Mr. Ashok, an individual, aged 50 years, whose gross total income before deduction under section 80C is Rs. 2,60,000 and total income after deduction under section 80C is Rs.1,05,000.
- (b) M/s. N.R.K & Co., a firm, which has incurred a loss.

Solution

- (a) As per fourth proviso to section 139(1), every person (other than company and firm) whose total income or total income of any other person in respect of which he is assessable exceeds the maximum amount not chargeable to tax, shall furnish a return of income.
For this proviso, total income means total income without giving effect to the provisions of sections 10A, 10(38) and sections 80C to 80U.
The total income before giving effect to the 80C of Mr. Ashok exceeds basic exemption limit of Rs.2,50,000. Therefore, Mr. Ashok is required to furnish return of income.
- (b) It is compulsory for firms to furnish return of income or loss on or before the due date. Therefore, M/s N.R.K & Co., is required to furnish return of loss.

Readers Note:**Practical 2**

Mr. Mohan is engaged in growing & manufacturing Tea. His composite income from this activity under the head "PGBP" for the concerned previous year is Rs.6,25,000. Advise him regarding filing return u/s 139(1) assuming that he does not have any other income.

Solution

As per **circular No. 10, 2003**, CBDT clarified that when the assessee is engaged in growing and manufacturing tea, coffee or rubber then only taxable income out of composite income shall be taken into consideration while deciding whether such Individual/HUF should submit return or not.

In this case taxable income is 40% of Rs. 6,25,000 = Rs. 2,50,000 and therefore Mr. Mohan is not required to submit return since taxable income does not exceed exemption limit of Rs.2,50,000.

Readers Note:**Due Dates for filing Income Tax Return under section 139(1)**

Different situations	Due date of submission of return
1. Where the assessee is required to furnish a report in Form No. 3CEB under section 92E	November 30 of assessment year
2. Where the assessee is a company [not required to furnish report under section 92E]	September 30 of assessment year
3. Where the assessee is a person other than a company [not required to furnish report under section 92E]	
3.1 where accounts of the assessee are required to be audited under this Act or under any other law	September 30 of assessment year
3.2 where the assessee is a "working partner" in a firm whose accounts are required to be audited under this Act or under any other law	September 30 of assessment year
3.3 In any other case	July 31 of assessment year

(vi) **Section 234F** provides for late fee, the summary for the A.Y. 2019-20 is as under:

Date of Filing return	Total income does not exceed Rs. 5,00,000	Total income exceeds Rs.5,00,000
After due date under section 139(1) but on or before 31.12.2019	1000	5000
Between 01.01.2020 to 31.03.2020	1000	10000

This fee is in addition to the interest payable under section 234A.

Practical 3

Specify the quantum of Fee, if any, to be levied in the following cases.

- Mr. Abhishek, an individual whose total income for the **A.Y. 2019-20** worked out to Rs. 15 lakhs, filed the return of income on **12-03-2020**.
- Ms. Jagruti filed the return of income on **31-01-2020** for the assessment year **2019-20** declaring gross total income of Rs. 5,80,000 and claimed deduction under section 80C Rs. 90,000.

Solution

- Rs. 10,000
- Rs. 1,000

Readers Note:

20.2 RETURN OF LOSS**Section:- 139(3)**

- A loss sustained by the assessee in any previous year under the
 - (a) Section 72(1) - Profits and Gains of business or profession
 - (b) Section 73(2) - Speculation business
 - (c) Section 73A(2)-Specified business
 - (d) Section 74A(3) - Owning and maintaining of horse races
 - (e) Section 74(3) - Capital Gains
 can be carried forward only if the return is furnished within the time allowed u/s. 139(1).
- Section 139 (3) read with section 80 is not applicable to the followings:
 - (a) Unabsorbed depreciation u/s 32(2)
 - (b) Loss under the head "Income from house property" u/s. 71B
 That means above mentioned unabsorbed allowance / losses can be carried forward even if return is not furnished within the time allowed under section 139(1).

**SECTION 119-POWERS OF CBDT**

The Board may, if it considers it desirable or expedient so to do for avoiding genuine hardship in any case or class of cases, by general or special order, authorize any income-tax authority, not being a Commissioner (Appeals) to admit an application or claim for any exemption, deduction, refund or any other relief under this Act after the expiry of the period specified by or under this Act for making such application or claim and deal with the same on merits in accordance with law.

‡ **Circular No.8 / 2001 dated 16th May 2001** ‡

The assessee shall be eligible to carry forward the losses even if return is not filed on or before due date u/s 139(1), if delay is due to genuine hardship. The Assessing Officer with the prior approval of CIT can condone delay u/s. 119(2)(b) in respect of a loss up to Rs.10,00,000. When loss exceeds Rs. 10,00,000 but does not exceed Rs. 50,00,000 then A.O. shall obtain the prior approval of CCIT. Where loss exceeds Rs. 50,00,000 then prior approval of Board is required.

Practical 4

Rajesh regularly files his return of income electronically. While he was trying to upload his return of income for assessment year **2019-20** on **31st July, 2019**, 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, 2019**. The return contained a claim for carry forward of business loss of Rs.1 lakh. This circumstance was recorded in a letter delivered to the office of the Deputy Commissioner of Income Tax on **1st August, 2019** 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.

Solution

- 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.

- Further, considering the impact of circular No. 8 /2001, 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 Rs. 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.

Readers Note:

20.3 BELATED RETURN

Section:- 139(4)

Any person who has not furnished his return of income within the time allowed u/s. 139(1), then, the belated return under this section may be furnished at any time before the end of the relevant assessment year or before the completion of assessment, whichever is earlier.

20.4 RETURN BY CHARITABLE TRUST

Section:- 139(4A)

The charitable or religious trust whose income exceeds the maximum amount that is not chargeable to income tax before giving exemption u/s. 11 and 12 shall furnish its return within the prescribed period.

20.5 RETURN BY POLITICAL PARTIES

Section:- 139(4B)

The chief executive of every political party shall furnish the return of income in the prescribed form within the prescribed due date if its total income exceeds the maximum amount not chargeable to tax before giving effect to the provision u/s. 13A.

20.6 RETURN BY CERTAIN ASSOCIATIONS/INSTITUTIONS

Section:- 139(4C)

The following entities shall furnish their return of income if the total income, before giving effect to the exemption under section 10, exceeds exemption limit

- (i) Research association –Section 10(21)
- (ii) News agency – Section 10 (22B)
- (iii) association or institution referred to in Section 10(23A) / (23B)
- (iv) Funds established for welfare of employees or their dependents notified by the Board under section 10(23AAA)**
- (v) Fund or Institution, University or other educational institution or hospital or other medical Institution referred to under section 10(23C) (iiiab)/ (iiiac)/ (iiiad)/(iiiae)/(iv)/(v)/(vi)/(via)
- (vi) *Mutual Fund referred to in section 10(23D)*
- (vii) *Securitisation trust referred to in section 10(23DA)*
- (viii) Investor protection fund set up by commodity exchange - Section 1023(EC)**
- (ix) Investor protection fund set up by depository - 1023(ED)**

- (x) **Core Settlement Guarantee fund set up by Clearing Corporation - Section 1023(EE)**
- (xi) **Various Boards (Tea Board/ Coffee Board..) and Certain Authorities referred to in Section 10(29A)**
- (xii) *Venture capital company or venture capital fund referred to in section 10(23FB)*
- (xiii) Trade Union or association covered under section 10(24).
- (xiv) Section 10(29A)
- (xv) Any body or authority or board or trust referred to in section 10 (46)
- (xvi) Infrastructure debt fund referred to in section 10(47)

Practical 5

Discuss obligation of followings to file income tax return

Sr. No.	Name of the entity	Total income before giving effect to the provisions of section 10 (Rs.)
1.	Competition Commission of India	50.25 Crores
2.	Prasar Bharati	10.22 Crores
3.	Reliance Mutual Fund	22.78 Crores
4.	Trade Union	2.08 lacs
5.	Insurance Regulatory Development Authority (IRDA)	8.05 Crores

Solution

Sr. No.	Name of the entity	Total income before giving effect to the provisions of section 10 (in Rs.)	Section under which entity is eligible for exemption	Whether entity falls in the list of section 139(4C)?	Whether return is required to be filed?
1	Competition Commission of India	50.25 Crores	Section 10(46)	Yes	Yes
2	Prasar Bharati	10.22 Crores	Section 10(23BBH)	No	No
3	Reliance Mutual Fund	22.78 Crores	Section 10(23D)	Yes	Yes
4	Trade Union	2.08 lacs	Section 10(24)	Yes	No because income does not exceed exemption limit
5.	Insurance Regulatory and Development Authority (IRDA)	8.05 Crores	Section 10(23BBE)	No	No

Readers Note:

20.7 RETURN BY CERTAIN SCIENTIFIC RESEARCH INSTITUTES, UNIVERSITIES OR COLLEGES**Section:- 139(4D)**

Whether there is income or loss, every university, college or other institution referred to in clause (ii) and clause (iii) of Section 35(1), shall furnish return of income and all the provisions of this Act shall, so far as may be, apply as if it were a return required to be furnished under section 139(1).

20.8 RETURN BY BUSINESS TRUST**Section:- 139(4E)**

Whether there is income or loss, every business trust shall furnish return of income and all the provisions of this Act shall, so far as may be, apply as if it were a return required to be furnished under section 139(1).

20.9 RETURN BY INVESTMENT FUND**Section:- 139(4F)**

Whether there is income or loss, every investment fund referred to in section 115UB shall furnish return of income and all the provisions of this Act shall, so far as may be, apply as if it were a return required to be furnished under section 139(1).

20.10 REVISED RETURN**Section:- 139(5)****Conditions for filing revised return**

- (i) The original return must have been furnished under section 139(1) or section 139(4) and
- (ii) The assessee discovers an omission or wrong statement therein.

then, the revised return under this section may be furnished before the end of the relevant assessment year or before the completion of assessment, whichever is earlier.

Important consequence once revised return is filed: As per various judicial pronouncements, once a return is furnished under this sub-section, all the provisions of the Income-tax Act, 1961 shall apply as if such return has been furnished u/s. 139(1)/(4).

Fill in the blanks:

- (a) Belated return _____ be revised (can/cannot)
- (b) Revised return replaces _____ return. [**Dhampur sugar mills Ltd. V CIT (1973) 90 ITR 236 (All)**].
- (c) Filing of a revised return after discovery of the omission or wrong statement is not by itself sufficient to bring the revised return within the ambit of section 139(5). A further requirement is that this omission or wrong statement in the original return must be due to a _____ (bonafide / Malafide) inadvertence or mistake on the part of the assessee. [**Sunanda Ram Deka v. CIT (1994) 210 ITR 988 (Gau)**].
- (d) Second revised return _____ be submitted (Can/Cannot)
- (e) Original return filed under section 139(1) declaring loss of Rs. 8,00,000. However, assessee failed to include Loss from Business D amounting to Rs. 3,50,000 and therefore submitted revised return declaring total loss of Rs. 11,50,000. Assessee is entitled to carry forward loss of Rs. _____. [**CIT Vs. Periyar District Co-operative Milk Producers Union Ltd. [2004] 266 ITR 705 (Mad.)**]

Solution:

(a) Can (b) original (c) bonafide (d) Can (e) Rs. 11,50,000

Practical 6

Ram, an individual, filed his return of income for the concerned assessment year. 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?

Solution

- A return of income filed 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 or belated return subject to few conditions. There is no provision in the Income-tax Act to make changes or modification in the return of income by addressing a letter to the assessing officer.
- In a case where a return of income has been filed, 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).
- The **Supreme Court in Goetze (India) Ltd. vs. CIT (2006) 284 ITR 323** has held that there was no provision in the Income-tax Act to allow an amendment in the return of income filed except by way of filing a revised return. Therefore, a fresh claim can be made before the Assessing Officer only by filing a revised return and not otherwise.
- 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.

Readers Note:**20.11 DEFECTIVE RETURN****Section:- 139(9)**

This section has an overriding effect over all the provisions of Income Tax Act

Rectification of Defect:-

The Assessing Officer may at his discretion intimate to the assessee the defect in the return.

Time Limit for rectification: - The time limit for rectification shall be **15 days from the date of such intimation** or such extended period allowed by the Assessing Officer.

<i>The assessee fails to rectify the defect within 15 days or such extended time limit</i>	<i>Assessee rectifies the defect after the expiry of 15 days or such extended time but before the assessment is made</i>
(i) The return shall be treated as an <u>invalid return</u>	The Assessing Officer <u>may condone the delay</u> and treat return as a valid return.
(ii) The <u>provisions</u> of this Act shall <u>apply as if the assessee had failed to furnish the return</u>	

As per explanation to section 139(9), a return of income shall be regarded as defective in the following cases:

- (a) The annexure, statements and columns in the return of income has not been duly filled in.
- (b) The return is not accompanied by the following:

- (i) Statement showing the computation of tax.
- (ii) Audit report u/s. 44AB or
- (iii) Proof of TDS/TCS, advance tax or self – assessment tax paid.
- (iv) Proof the compulsory deposit made under Compulsory Deposit Scheme.
- (v) Audited Profit and Loss account, Balance Sheet and Auditor's Report (including Cost Audit Report under section 233B of the Companies Act) if the accounts of the assessee have been audited under any other law.
- (vi) **Where regular books of account are maintained by the assessee:-**
 - i. Manufacturing Account, Trading Account, Profit and Loss account, or Income and Expenditure account or similar account and Balance Sheet
 - ii. In case of the proprietary business, personal account of the proprietor; in case of firm, AOP/BOI, the accounts of the partners/members and in case of a partner / member his personal account in the firm, AOP/BOI.
- (vii) **Where regular books are not maintained by the assessee:-**
 - i. statement indicating the turnover, gross receipts, gross profit, expenses and net profit and the basis of such computation
 - ii. Statement of sundry debtors, creditors, stock in trade and cash balance at the end of the previous year

REMARKS:

- (1) Due to provisions of section 139C/139D and the present ITR forms, it is not possible to attach any certificates, audit reports, computation of total income, financial statements, and proof of various pre-paid taxes. Therefore, practically, return of income may not be regarded as defective because of non-fulfillment of requirements mentioned at point no. (b) above.
- (2) **Relevant portion from Notification No. 3/2012, dated 04-01-2012**
- (i) In case of a defective return, the Commissioner shall intimate this to the person through e-mail or by placing a suitable communication on the e-filing website.
 - (ii) A person shall comply with the notice regarding defective return by uploading the rectified return within the period of time mentioned in the notice.
 - (iii) The Commissioner may, in order to avoid hardship to the person, condone the delay in uploading of rectified return.
 - (iv) In case no response is received from the person in reply to the notice of defective return, the Commissioner may declare a return as not having been uploaded at all or process the return on the basis of information available

**SECTION 292B: Return, Notice etc. not to be invalid on certain grounds.**

In this connection, a reference may be made to section 292B of the Income-tax Act which provides that no return of income, assessment, notice, summons or other proceedings furnished, made, issued or taken shall be invalid merely by reason of mistake, defect or omission in such return of income, order, notice, summons etc.

The provision in section 139(9), however, overrides other provisions of the income-tax Act (including section 292B) in this regard and in a case where any of the specified defect is not removed within the time allowed, the return shall be treated as an invalid return and the provisions of the Income-tax Act apply as if the assessee had failed to furnish the return. – **Circular No. 281, dated 22-9-1980.**

Fill in the blanks:

- (a) The defects mentioned in the section 139(9) are _____ (illustrative / exhaustive) [*Rai Bahadur Bissesswarlal Motilal Malwasie Trust 195 ITR 825 [1992](Cal.)*]
- (b) The assessee submitted e-return. But it is not verified at all. Hence, the return was an absolutely _____ (Invalid/Defective) as it had a glaring inherent defect which could not be cured inspite of the deeming effect of section 292B. [*CIT V. Harjinder Kaur 310 ITR 71 (P & H)*]

Solution: (a) illustrative (b) Invalid

20.12 | PERMANENT ACCOUNT NUMBER

Section:- 139A

- (1) Every person,—
- (i) if his total income or the total income of any other person in respect of which he is assessable under this Act during any previous year exceeded the exemption limit; or
 - (ii) carrying on any business or profession whose total sales, turnover or gross receipts are or is likely to exceed five lakh rupees in any previous year; or
 - (iii) who is required to furnish a return of income under sub-section (4A) of section 139;
 - (iv) being a resident, other than an individual, which enters into a financial transaction of an amount aggregating to two lakh fifty thousand rupees or more in a financial year. [*Amendment made by Finance Act, 2018 w.e.f. 1-4-2018*]
 - (v) who is the managing director, director, partner, trustee, author, founder, karta, chief executive officer, principal officer or office bearer of the person referred to in clause (iv) or any person competent to act on behalf of the person referred to in clause (v). [*Amendment made by Finance Act, 2018 w.e.f. 1-4-2018*]
- and who has not been allotted a permanent account number shall, within such time, as may be prescribed, apply to the Assessing Officer for the allotment of a permanent account number.

20.13 | QUOTING OF AADHAAR NUMBER

Section:- 139AA

Every person who is eligible to obtain Aadhaar number shall, on or after the 1st day of July, 2017, quote Aadhaar number—

- (i) in the application form for allotment of permanent account number;
 - (ii) in the return of income:
- (1) However, where the person does not possess the Aadhaar Number, the Enrolment ID of Aadhaar application form issued to him at the time of enrolment shall be quoted in the application for permanent account number or, as the case may be, in the return of income furnished by him.
- (2) Every person who has been allotted permanent account number as on the 1st day of July, 2017, and who is eligible to obtain Aadhaar number, shall intimate his Aadhaar number to such authority in such form and manner as may be prescribed, on or before a date to be notified by the Central Government in the Official Gazette:
- In case of failure to intimate the Aadhaar number, the permanent account number allotted to the person shall be deemed to be invalid and the other provisions of this Act shall apply, as if the person had not applied for allotment of permanent account number.

(3) The provisions of this section shall not apply to such person or class or classes of persons or any State or part of any State, as may be notified by the Central Government in this behalf, in the Official Gazette.

‡ **Notification No. 37/2017, F. No. 370133/6/2017-TPL** ‡

As per Notification No. 37/2017, the provisions of section 139AA shall not apply to an individual who does not possess the Aadhaar number or the Enrolment ID and is:-

- (i) residing in the States of Assam, Jammu and Kashmir and Meghalaya;
- (ii) a non-resident as per the Income-tax Act, 1961;
- (iii) of the age of eighty years or more at any time during the previous year;
- (iv) not a citizen of India

20.14 RETURN UNDER SECTION 139 BY WHOM TO BE VERIFIED

Section:- 140

ASSESSEE	VERIFICATION TO BE DONE BY
Individual When he is absent from India or mentally incapacitated or for any other reason he is not able to verify	Individual himself His guardian or any other person competent to act on his behalf duly authorized by him
H. U. F Karta is absent from India or he is mentally incapacitated	Karta Any other adult member of the family
Company Managing Director is unable to verify or there is no M.D. Company is not resident in India Company is in Liquidation Company's management is taken over by the government An application has been admitted by the Adjudicating Authority in respect of company under section 7, 9, or 10 of the Insolvency and Bankruptcy Code, 2016.	Managing Director Any other director Holder of a valid Power of Attorney The Liquidator The Principal Officer Insolvency professional appointed by Adjudicating Authority [Inserted by Finance Act, 2018, w.e.f. A.Y.2019-20]
Partnership Firm	Managing Partner or any other partner not being a minor
Limited liability partnership firm Where for any unavoidable reason such designated partner is not able to verify Where there is no designated partner	Designated partner Any Partner Any partner
Local authority	Principal Officer

Political Party	Chief executive officer
Association of Persons	Any member or principal officer
Any other person	That person or some other person who is competent to verify on his behalf.

20.15 SELF – ASSESSMENT TAX**Section:- 140A**

- An assessee is required to submit his return of income under section 139 or 142 or 148 or 153A.
- Self-Assessment tax payable by the assessee shall be worked out in the following manner:-

Particulars	Rs.
Compute Total Income under Income Tax Act	XXX
Compute tax on total income as per rates in force together with SC and EC	XXX
Less: TDS / TCS /Advance tax/relief under section 90,91, 90A/Tax credit under sec.115JAA / Tax credit under section 115JD (AMT)	XXX
Add: Interest u/s 234A/ 234B/ 234C	XXX
Add: Late Fee u/s 234F	XXX
Self-Assessment tax payable (Amount Refundable)	XXX

- The return of income is to be accompanied by proof of payment of tax together with interest and fee.
- Where the amount paid by the assessee falls short of the aggregate of tax, interest and fee (fee under section 234F of the Act), the amount so paid shall first be adjusted towards the fee payable and thereafter towards interest and the balance, if any, shall be adjusted towards tax.
- After a regular assessment under section 143 or 144 or an assessment under section 153A has been made, any amount paid under section 140A shall be deemed to have been paid towards such regular assessment.
- If any assessee fails to pay whole or any part of such tax, interest or fee in accordance with this section, he shall be deemed to be an assessee in default and all the provision of the Act shall apply accordingly.

**SECTION 221: Penalty when assessee is in default**

When an assessee is in default or is deemed to be in default in making a payment of tax, he shall, in addition to the amount of the arrears and the amount of interest payable under sub – section (2) of section 220, be liable, by way of penalty, to pay such amount as the Assessing Officer may direct, and in the case of a continuing default, such further amount or amounts as the Assessing Officer may, from time to time, direct, so however, that the total amount of penalty does not exceed the amount of tax in arrears.

However, before levying any such penalty, the assessee shall be given a reasonable opportunity of being heard. Further, where the assessee proves to the satisfaction of the Assessing Officer that the default was for good and sufficient reasons, no penalty shall be levied under this section.

**SECTION 222: Certificate to be drawn by TRO**

When an assessee is in default or is deemed to be in default in making a payment of tax, the Tax Recovery Officer may draw up under his signature a statement in Form No. 57 specifying the amount of arrears due from the assessee (such statement being hereafter referred to as “certificate”) and shall proceed to recover from such assessee the amount specified in the certificate by one or more of the modes mentioned below, in accordance with the rules laid down in the Second Schedule.

- (a) attachment and sale of the assessee's movable property;
- (b) attachment and sale of the assessee's immovable property;
- (c) arrest of the assessee and his detention in prison;
- (d) appointing a receiver for the management of the assessee's movable and immovable properties.

20.16 INQUIRY BEFORE ASSESSMENT

Section:- 142(1)

Notice for filing return of income

Notice shall be issued to any person requiring him to furnish return of income if the said person has not filed the return of income within the time allowed u/s. 139(1) or before the end of relevant assessment year.

Considering the effect of proviso to section 142 (1) (i), such notice can be issued even after the expiry of assessment year.

The Assessing Officer may serve notice on any person, **whether he has filed return or not** requiring him to:

Requirement	Restrictions
Produce or cause to be produced, such accounts or documents as he may require	Accounts shall not relate to a period more than three years prior to the previous year.
Furnish such information in writing as he may require including a statement of all assets and liabilities whether included in the accounts or not.	Previous approval of the Joint Commissioner shall be obtained before requiring the assessee to furnish a statement of assets and liabilities not included in the accounts.

20.17 INQUIRIES

Section:- 142(2)

The Assessing Officer can make such inquiries necessary for obtaining full information regarding income or loss of any person.

20.18 SPECIAL AUDIT

Section:- 142(2A)

The direction for special audit can be issued at any stage of proceedings if

- (i) the Assessing Officer having regard to
 - the nature and complexity of the accounts,
 - volume of the accounts,
 - doubts about the correctness of the accounts,
 - multiplicity of transactions in the accounts or
 - specialised nature of business activity of the assessee,
 - and in the interest of revenue, is of the opinion that the accounts shall be audited.
- (ii) Prior approval of the Chief Commissioner or Commissioner shall be obtained.
- (iii) However, the Assessing Officer shall not direct the assessee to get the accounts audited unless the assessee has been given a reasonable opportunity of being heard.

Nomination of Auditor and expenses of audit

- (i) The Chief Commissioner / Commissioner shall nominate the auditor and his decision in this regard is final.
- (ii) On or after the 1st day of June, 2007, the expenses of, and incidental to, such audit (including the remuneration of the Accountant) shall be determined by the Chief Commissioner or Commissioner and the expenses so determined shall be paid by the Central Government.

Time limit for submission of audit report and law relating to re-audit.

- (i) The audit report shall be furnished within the period specified by the A. O. or extended time. Such extension can be done either by the A.O. *on his own motion (Amendment Finance Act, 2008)* or on application made by assessee.
- (ii) The total time limit (including such extended time) shall not exceed 180 days.
- (iii) Assessing Officer can direct the assessee to get his accounts audited under this section even if the accounts are already audited under this Act or under any other law.- ***Super Cassettes Industries Ltd. V CIT (1999) 102 Taxman 202 (Delhi).***

20.19	OPPORTUNITY OF BEING HEARD

Section:- 142(3)

The assessee shall be given a reasonable opportunity of being heard in respect of any material gathered on inquiry u/s.142/142(2A) and proposed to be used in the assessment except assessment to be completed u/s. 144.

Practical	7

Mr. X had not filed return for A.Y. **2019-20** though due date was **30/09/2019**. He was in receipt of notice u/s 142(1) requiring him to file return on or before **15/12/2019**. Mr. X didn't respond. A.O. issued another notice u/s 142(1) requiring him to file return on or before **31/12/2019**. He filed return on **15/02/2020**. On **19/02/2020** he received an assessment order u/s 144 and order was signed by A.O. on **13/02/2020**. Mr. X challenged assessment order on following grounds:

- (i) Assessment had been framed without giving opportunity of being heard.
- (ii) A.O. had not acted upon the return which was very well in time as per section 139(4).

Discuss validity of contentions raised by Mr. X.

Solution

- (i) If notice u/s 142(1) is received and it is not complied with then as per sec 142(3) (opportunity of being heard), no opportunity of being heard is to be given to the assessee particularly when assessment is completed u/s 144.
- (ii) As per provision of sec 139(4) belated return can be submitted – before the end of relevant A.Y. **(31/3/2020)**.

Or

before completion of assessment. **(13/2/2020).**{*whichever is earlier*}

However, Mr. X submitted return on **15/2/2020**. Therefore, return submitted by Mr. X is not valid.

Hence, both the contentions raised by Mr. X are not tenable.

Readers Note:

20.20 | ESTIMATES BY VALUATION OFFICER IN CERTAIN CASES

Section:- 142A

- (1) The Assessing Officer may, for the purposes of assessment or reassessment, make a reference to a Valuation Officer to estimate the value, including fair market value, of any asset, property or investment and submit a copy of report to him.
- (2) The Assessing Officer may make a reference to the Valuation Officer whether or not he is satisfied about the correctness or completeness of the accounts of the assessee.
- (3) The Valuation Officer, on a reference made, shall, for the purpose of estimating the value of the asset, property or investment, have all the powers that he has under section 38A of the Wealth-tax Act, 1957.
- (4) The Valuation Officer shall, estimate the value of the asset, property or investment after taking into account such evidence as the assessee may produce and any other evidence in his possession gathered, after giving an opportunity of being heard to the assessee.
- (5) The Valuation Officer may estimate the value of the asset, property or investment to the best of his judgment, if the assessee does not co-operate or comply with his directions.
- (6) The Valuation Officer shall send a copy of the report of the estimate made, to the Assessing Officer and the assessee, within a period of six months from the end of the month in which a reference is made.
- (7) The Assessing Officer may, on receipt of the report from the Valuation Officer, and after giving the assessee an opportunity of being heard, take into account such report in making the assessment or reassessment.

Practical 8

During the course of scrutiny proceedings, MNO Limited submitted all the details called for including books of accounts of the company. During the year under scrutiny, MNO Limited had made investment in immovable property. The Assessing Officer was satisfied with the books of accounts and therefore accepted book results but he would like to refer matter to the valuation officer for ascertaining fair market value of captioned immovable property. MNO Limited objected such reference on the ground that Assessing Officer cannot refer matter to the valuation officer without the books being first rejected.

Discuss the validity of objections raised by MNO Limited.

Solution

As per provisions of section 142A(2), the Assessing Officer may make a reference to the Valuation Officer whether or not he is satisfied about the correctness or completeness of the accounts of the assessee. Considering this, the objection raised by MNO Limited is not sustainable.

Readers Note:**20.21 | INTIMATION / POPULARLY KNOWN AS SUMMARY ASSESSMENT**

Section:- 143(1)

- (1) Where a return has been made under section 139, or in response to a notice under section 142(1), such return shall be processed in the following manner, namely:-
 - (a) the total income or loss shall be computed after making the following adjustments, namely;
 - i. any arithmetical error in the return or
 - ii. any incorrect claim, if such incorrect claim is apparent from any information in the return;
 - iii. disallowance of loss claimed, if return of the previous year for which set off of loss is claimed was furnished beyond the due date specified under sub-section (1) of section 139;

- 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 sections 10AA, 80-IA, 80-IAB, 80-IB, 80-IC, 80-ID or section 80-IE, if the return is furnished beyond the due date specified under sub-section (1) of section 139; or
- vi. addition of income appearing in Form 26AS or Form 16A or Form 16 which has not been included in computing the total income in the return:

Provided that no such adjustments shall be made unless an intimation is given to the assessee of such adjustments either in writing or in electronic mode:

Provided further that the response received from the assessee, if any, shall be considered before making any adjustment, and in a case where no response is received within thirty days of the issue of such intimation, such adjustments shall be made.

Provided also that no adjustment shall be made under sub-clause (vi) in relation to a return furnished for the assessment year commencing on or after the 1st day of April, 2018; **[Inserted by Finance Act, 2018, w.r.e.f. A.Y.2018-19]**

- (b) the tax, interest and fee shall be computed on the basis of the total income computed under clause (a) above;
- (c) the sum payable by, or the amount of refund due to, the assessee shall be determined after adjustment of the tax, interest and fee, if any, computed under clause (b) above by any tax deducted at source, any tax collected at source, any advance tax paid, any relief allowable under an agreement under section 90 or section 90A, or any relief allowable under section 91, any rebate allowable under Part A of Chapter VIII, any tax paid on self-assessment and any amount paid otherwise by way of tax, interest and fee;
- (d) the intimation shall be prepared or generated and sent to the assessee specifying the sum determined to be payable, or the amount of refund due to, the assessee after aforesaid corrections;
- (e) the amount of refund due to the assessee shall be granted to him.

Provided that intimation shall also be sent to the assessee in a case where the loss declared in the return by the assessee is adjusted but no tax, interest or fee is payable by, or no refund is due to him.

Time limit

No intimation shall be sent under this section after the expiry of one year from the end of the financial year in which the return is made. The acknowledgment of return shall be deemed to be the intimation in a case where no sum is payable by, or refundable to the assessee, and where no adjustment has been made.

Meaning of incorrect claim

It means such claim on the basis of an entry, in the return-

- (a) of an item, which is inconsistent with another entry of the same or some other item in such return;
- (b) in respect of which, information required to be furnished to substantiate such entry, has not been furnished;
- (c) in respect of a deduction, where such deduction exceeds specified statutory limits which may have been expressed as monetary amount or percentage or ratio or fraction.

- (1A) For the purpose of processing the returns as mentioned above, the Board may make a scheme for centralized processing of returns with a view to expeditiously determining the tax payable by, or the refund due to, the assessee.
- (1B) For the purpose of giving effect to the scheme, the Central Government may, by notification, direct that any of the provisions of the Act relating to processing of returns shall not apply or shall apply with such exceptions, modifications and adaptations as may be specified in that notification. Further, such notification may be issued at any time but not after 31st March, 2012.

(1C) Every such notification shall be laid before each house of Parliament.

(1D) Notwithstanding anything contained in section 143(1), the processing of a return shall not be necessary, where a notice has been issued to the assessee under section 143(2).

Provided that the provisions of this sub-section shall not apply to any return furnished for the assessment year commencing on or after the 1st day of April, 2017.

Practical 9

The assessee submitted the income tax return for A.Y. 2018-19 declaring total income at Rs. 8,02,000. This return was submitted under section 139(4) of the Act. The CPC, Bangalore, while processing the said return found following issues:

Sr. No.	Particulars
(a)	While computing income under head "PGBP", interest income of Rs. 33,000 was reduced declaring that it shall be offered under the head "IFOS", however, assessee failed to include such income under the head "IFOS".
(b)	Depreciation on computers were claimed at 60% instead of 40%. Depreciation claimed on computers was Rs. 30,000.
(c)	Claimed set off of business loss brought forward Rs. 1,02,000 pertaining to A.Y. 2017-18. The income tax return for the said A.Y. was submitted under section 139(4) of the Act.
(d)	His case was subject to audit under section 44AB(a). The auditor, in tax audit report, has made a remark that cash payment of Rs. 34,000 has been made for repairing of machine on a single day to Brahmani Engineering. However, assessee failed to add back while computing income under the head "PGBP"
(e)	Claimed deduction of Rs. 13,05,000 under section 80-IAC of the Act
(f)	Bank interest income of Rs. 88,000 appearing in Form no. 26AS on which tax has been deducted but assessee failed to include the same in the income tax return.

You are required to compute total income to be processed by CPC, Bangalore.

20.22 NOTICE FOR SCRUTINY/ REGULAR ASSESSMENT

Section:- 143(2)

To ensure that the assessee has not

(a) understated the income or (b) computed excessive loss or (c) underpaid the tax in any manner;

The Assessing Officer or the prescribed income-tax authority may **serve a notice** on the assessee requiring him on a date to be specified in this notice, either:

(i) to attend the office of Assessing Officer; or (ii) to **produce, or cause to be produced before the Assessing Officer any evidence on which the assessee may rely in support of the return.**

Time limit:- No notice shall be served after the expiry of 6 months from the end of the financial year in which the return is furnished.

20.23 SCRUTINY/REGULAR ASSESSMENT

Section:- 143(3)

(i) The Assessing Officer shall take into account all relevant material gathered by him and also the evidence produced by the assessee.

(ii) On this basis, he shall make an assessment of the total income or loss of the assessee.

(iii) On the basis of such assessment, he shall determine the sum payable by the assessee or refund due to him.

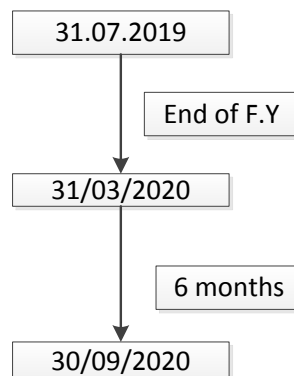
Practical 10

Mr. Joy filed return for the **A.Y. 2019-20** on **31.07.2019**, A.O. served a notice u/s 143(2) requiring him to produce evidence. The notice was dated **30/09/2020** but served to Mr. Joy on **10/10/2020**. During the course of hearing, Mr. Joy challenged the jurisdiction of assessing officer on the ground that the assessing officer failed to serve notice under section 143(2) in time. Whether contention raised by Mr. Joy is valid?

Solution

Whenever assessment is sought to be made, assessing officer must assume proper jurisdiction over the case of taxpayer by issuing and serving valid notice as per the provisions of the Income Tax Act, 1961.

Section 143(2) requires service of notice within six months from the end of financial year in which return is furnished.



Considering the above time limit, notice for scrutiny must be served to Mr. Joy on or before **30/9/2020**, while in present case, it has been served on **10/10/2020**. Therefore, the contention raised by Mr. Joy for challenging jurisdiction of the assessing officer is valid.

As a result, any order passed by the assessing officer under section 143(3) of the Act, in case of Mr. Joy, for the **A.Y. 2019-20** shall be considered as null and void.

Readers Note:

Practical 11



Section 143(1) – section 143(2)

Mr. X filed return for **A.Y.2019-20** on **15/07/2019** declaring total income of Rs.3,51,000. A.O. issued intimation u/s 143(1) determining total income at Rs. 3,61,000 and raised a notice of demand of Rs.1,200. Intimation was served to assessee on **10/12/2019**. Assessee met demand in full on **12/12/2019**. A.O. thereafter served notice u/s 143(2) on **15/09/2020** requiring him to produce the evidence on which Mr. X relied in support of the return furnished. Mr. X challenged validity of notice on the ground that once summary assessment is done, notice for scrutiny assessment cannot be served. Whether contention raised by Mr. X is valid?

Solution

Intimation u/s 143(1) in fact is not an assessment, it is merely intimation. It is a mechanical process adopted by Income Tax department to make certain adjustments based on information contained in the return like disallowance of excess depreciation, reducing claim of 80C, wrong calculation of tax etc.

In this entire process, neither taxpayer nor the evidences are called upon to verify the correctness of return filed. Therefore, the contention raised by Mr. X challenging the scrutiny notice is not valid.

Readers Note:

Practical 12**SECTION 143(1)–Section 143(1D)-Section 143(3)-GEB's Case**

Mr. X, filed return for **A.Y. 2019-20** on **31/08/19**. He received notice for scrutiny on **31/12/19** requiring him to produce books of accounts on **15/01/20**. He responded and during the course of hearing, A.O. found error in rate of depreciation charged on plant and machinery. Therefore, assessing officer would like to issue intimation of demand u/s 143(1). Advise assessing officer.

Solution**Position before amendment made by Finance Act, 2017**

As discussed in earlier Practical, 143(1) is merely intimation while 143(3) is an assessment. Therefore income assessed u/s 143(3) prevails over income determined/ processed u/s 143(1).

Further, **Supreme Court in case of CIT v. Gujarat Electricity Board 260 ITR 84 (2003)** held that Once a regular assessment proceeding has been commenced under section 143(2), there is no need for a summary proceeding under section 143(1).

Considering the above, the assessing officer is advised not to issue intimation under section 143(1) but to make addition in relation to depreciation while passing order under section 143(3).

Position after amendment made by Finance Act, 2017

Section 143(1D), however has been amended and it states that the return shall be processed under section 143(1) even though notice under section 143(2) has been issued.

Considering the amendment, the assessing officer is advised to issue intimation under section 143(1) before passing order under section 143(3) of the Act.

Readers Note:**20.24 REASONS ENABLING E-ASSESSMENT****Section:- 143(3A) to 143(3C)****Section 143(3A)**

The Central Government may make a scheme, by notification in the Official Gazette, for the purposes of making assessment of total income or loss of the assessee under sub-section (3) so as to impart greater efficiency, transparency and accountability by—

- eliminating the interface between the Assessing Officer and the assessee in the course of proceedings to the extent technologically feasible;
- optimising utilisation of the resources through economies of scale and functional specialisation;
- introducing a team-based assessment with dynamic jurisdiction.

Section 143(3B)

The Central Government may, for the purpose of giving effect to the scheme made under sub-section (3A), by notification in the Official Gazette, direct that any of the provisions of this Act relating to assessment of total income or loss shall not apply or shall apply with such exceptions, modifications and adaptations as may be specified in the notification:

Provided that no direction shall be issued after the 31st day of March, 2020.

Section 143(3C)

Every notification issued under sub-section (3A) and sub-section (3B) shall, as soon as may be after the notification is issued, be laid before each House of Parliament.

20.25 BEST JUDGMENT ASSESSMENT**Section:- 144****When Best Judgment assessment can be made?**

Under Section 144	Under Section 145(2)
<i>Where a person fails to</i> (i) <u>Furnish</u> a return <u>u/s. 139</u> or (ii) Comply with all the terms of <u>notice</u> issued <u>u/s. 142(1)</u> or (iii) Comply with a <u>direction</u> issued <u>u/s. 142(2A)</u> i.e. <u>Audit</u> of accounts (iv) Comply with all the terms of a <u>notice</u> issued <u>u/s. 143(2)</u>	(a) Where the Assessing Officer is not satisfied about the correctness or completeness of the accounts of the assessee (b) No method of accounting has been regularly followed by the assessee (c) Where the "income computation and disclosure standards" notified by the Central Government have not been regularly followed by the assessee.

Opportunity of being heard:-

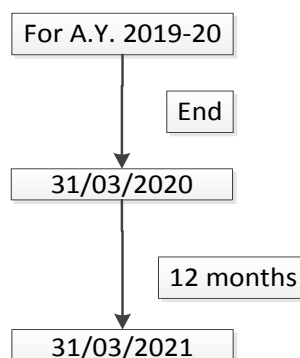
- (i) The assessee will be given an opportunity by a show cause notice as to why assessment shall not be completed to the best judgement of the Assessing Officer.
- (ii) **Opportunity need not be given where notice u/s. 142(1) has already been issued.**

20.26 TIME LIMIT FOR COMPLETION OF ASSESSMENTS AND CERTAIN PERIODS ARE EXCLUDED FROM THE TIME LIMIT FOR PASSING ASSESSMENT ORDERS**Section:- 153(1), 153(4) and Explanation 1 to Section 153****1. Time limit for completion of assessment under section 143(3)/ 144**Within 21 months **from** the end of relevant assessment year.**2. The abovementioned time limit for completion of assessment has been modified by Finance Act, 2017 as under:**

Assessment Year	Abovementioned time limit of 21 months shall be substituted by
2018-19	18 months
2019-20 and onwards	12 months

3. Time limit mentioned at Sr. No. 1 and 2 shall be extended by further twelve months, in case where reference is made to TPO under section u/s 92CA (1).

Let's take an illustration that for the assessment year **2019-20**, the assessing officer shall complete the assessment under section 143(3) or 144 on or before



However, the following time periods are excluded from the time limit for passing assessment orders.

- (i) the time taken in reopening the whole or any part of the proceeding or in giving an opportunity to the assessee to be re-heard under the proviso to section 129; or
- (ii) the period during which the assessment proceeding is stayed by an order or injunction of any court; or
- (iii) the period commencing from the date on which the Assessing Officer intimates the Central Government or the prescribed authority, the contravention of the provisions of section 10(21), section 10(22B), section 10(23A), section 10(23B) or section 10(23C) and ending with the date on which the copy of the order withdrawing the approval or rescinding the notification, under those clauses is received by the Assessing Officer; or
- (iv) the period commencing from the date on which the Assessing Officer directs the assessee to get his accounts audited under section 142(2A) and—
 - (a) ending with the last date on which the assessee is required to furnish a report of such audit under that sub-section; or
 - (b) where such direction is challenged before a court, ending with the date on which the order setting aside such direction is received by the Principal Commissioner or Commissioner; or
- (v) the period commencing from the date on which the Assessing Officer makes a reference to the Valuation Officer under section 142A(1) and ending with the date on which the report of the Valuation Officer is received by the Assessing Officer; or
- (vi) the period (not exceeding sixty days) commencing from the date on which the Assessing Officer received the declaration under sub-section (1) of section 158A and ending with the date on which the order under sub-section (3) of that section is made by him; or
- (vii) in a case where an application made before the Income-tax Settlement Commission is rejected by it or is not allowed to be proceeded with by it, the period commencing from the date on which an application is made before the Settlement Commission under section 245C and ending with the date on which the order under sub-section (1) of section 245D is received by the Principal Commissioner or Commissioner under sub-section (2) of that section; or
- (viii) the period commencing from the date on which an application is made before the Authority for Advance Rulings under section 245Q(1) and ending with the date on which the order rejecting the application is received by the Principal Commissioner or Commissioner under section 245R(3); or
- (ix) the period commencing from the date on which an application is made before the Authority for Advance Rulings under section 245Q(1) and ending with the date on which the advance ruling pronounced by it is received by the Principal Commissioner or Commissioner under section 245R(7); or
- (x) the period commencing from the date on which a reference or first of the references for exchange of information is made by an authority competent under an agreement referred to in section 90 or section 90A and ending with the date on which the information requested is last received by the Principal Commissioner or Commissioner or a period of one year, whichever is less; or
- (xi) the period commencing from the date on which a reference for declaration of an arrangement to be an impermissible avoidance arrangement is received by the Principal Commissioner or Commissioner under sub-section (1) of section 144BA and ending on the date on which a direction under sub-section (3) or sub-section (6) or an order under sub-section (5) of the said section is received by the Assessing Officer.

After extending, if the period available to the Assessing Officer for making an order is less than sixty days, then same shall be extended to sixty days.

Similarly, if the period available to the Transfer Pricing Officer is extended to sixty days in accordance with the proviso to sub-section (3A) of section 92CA and the period of limitation available to the Assessing Officer for making an order is less than sixty days, then same shall be extended to sixty days.

Similarly where a proceeding before the Settlement Commission abates under section 245HA, if the

period available to the Assessing Officer for making an is less than one year, then the same shall be extended to one year. Further, for the purposes of determining the period of limitation under sections 149, 153B, 154, 155 and for the purposes of payment of interest under section 244A, this provision shall also apply accordingly.

Practical 13

For the **A.Y. 2019-20**, the case of Good Better Best Private Ltd. was selected under scrutiny. During scrutiny proceedings, the Assessing Officer, on **15-03-2021**, had made a reference to Valuation Officer under section 142A for determining fair market value under section 69 of Income Tax Act. Thereafter, valuation officer determined fair market value and sent valuation report to Assessing Officer on **30-04-2021**. Find out the revised time limit available with assessing officer for completion of assessment under section 143(3).

Solution

Step 1: Regular Time Limit under section 153

12 months from the end of Assessment Year

End of the Assessment year + 12 months

31.3.2020 + 12 months

31.03.2021

Step 2: Revised Time Limit

Original Time Limit + days lost (the period commencing from the date on which the Assessing Officer makes a reference to the Valuation Officer under sub-section (1) of section 142A and ending with the date on which the report of the Valuation Officer is received by the Assessing Officer.)

31.03.2021 + 46 days

16.05.2021

Step 3: Minimum Time Limit

Day on which authority can reassume jurisdiction + 60 days

30.04.2021 + 60 days

29.06.2021

Step 4: Effective Time Limit

Step 2 or Step 3 whichever is later

29.06.2021

Readers Note:

20.27 NOTICE OF DEMAND

Section:- 156

When any tax, interest, penalty or any other sum is payable in consequence of any order passed, the Assessing Officer shall serve upon the assessee, a notice of demand in the prescribed form specifying the sum so payable.

Where any sum is determined to be payable by the assessee or by the deductor or by the collector under section 143(1) or section 200A (1) or 206CB(1), then intimation issued under those sections shall be deemed to be a notice of demand for the purpose of section 156.



SECTION 220(1): Time limit for payment of tax mentioned in demand notice

Any amount, otherwise than by way of advance tax, specified as payable in a notice of demand under section 156 shall be paid *within thirty days of the service of the notice* at the place and to the person mentioned in the notice.

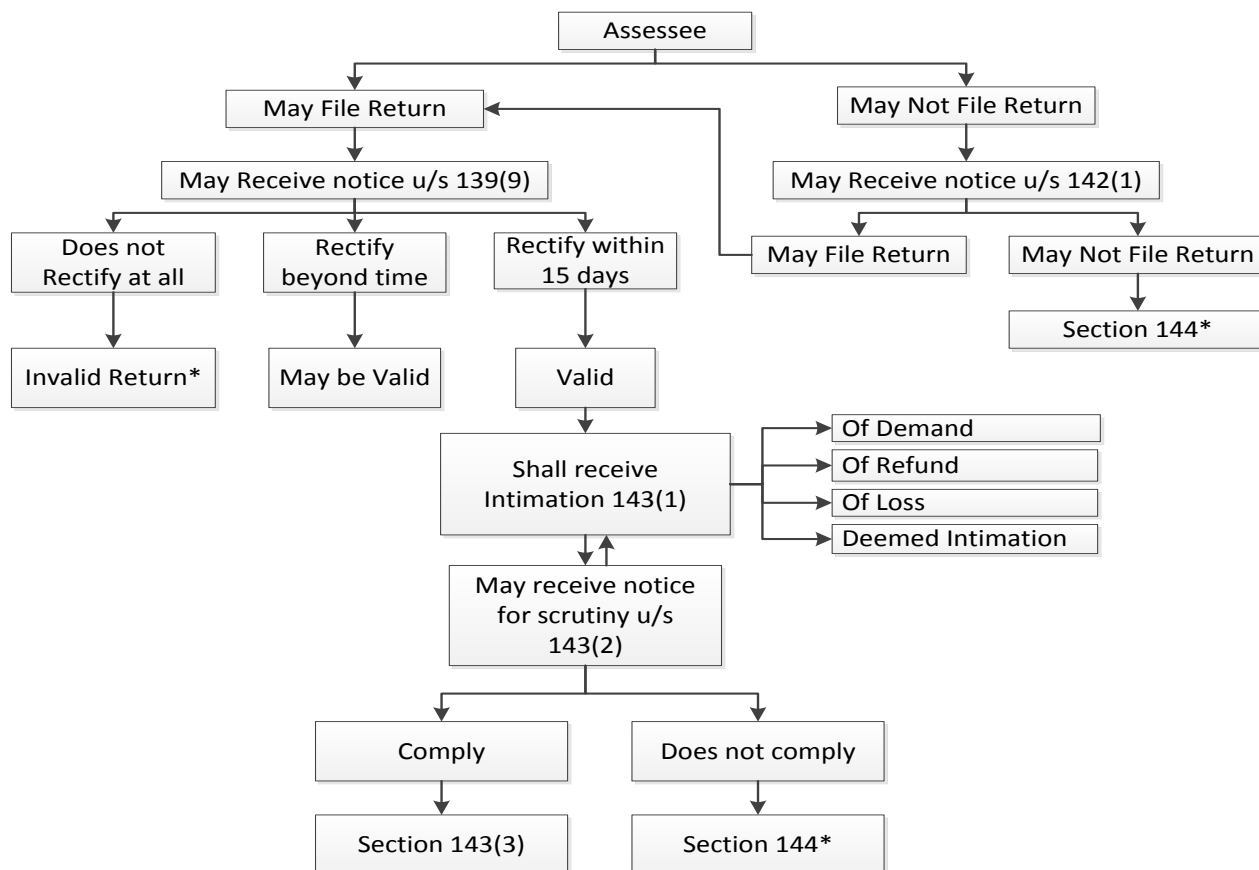
However, where the Assessing Officer has any reason to believe that it will be detrimental to revenue if the full period of thirty days aforesaid is allowed, he may, with the previous approval of the Joint Commissioner, direct that the sum specified in the notice of demand shall be paid within such period being a period less than the period of thirty days aforesaid, as may be specified by him in the notice of demand.



SECTION 246A: Appeal to Commissioner (Appeals)

Refer Topic Appeal to Commissioner of Income Tax (A)- **Section 246A**

Summary Chart of Assessment Procedure



Section 144*

Not complied with 143(2)	Not complied with 142(1)	Method of accounting-145
Failed to file return 139	Direction of Audit- 142(2A)	

20.28

SUMMARY OF PROCEEDINGS UNDER SECTION 147

Sr. No.	Primary Flow of Procedure under section 147
(1)	There must be an information or some tangible material with the assessing officer.
(2)	Such information or tangible material must be specific.
(3)	Based on such specific information or material, assessing officer should form a belief in a subjective manner that income has escaped assessment.
(4)	The assessing officer must record the reasons for re-opening.
(5)	He must obtain appropriate sanction (as mentioned under section 151) for issuing notice under section 148.

(6)	Thereafter notice under section 148 shall be served to the taxpayer requiring him to file return. Such notice must be issued within the time limit prescribed under section 149 read with section 150.
(7)	On receipt of notice under section 148, appropriate course of action on the part of assessee is to file return. (Such return will have same effect as if it is required to be filed under section 139).
(8)	Thereafter, assessee, if desires, then request assessing officer to supply the copy of reasons.
(9)	On receipt of the request, the assessing officer is obliged to supply the reasons within reasonable time.
(10)	Thereafter, assessee may prefer to file an objection to the assessing officer.
(11)	On being filed objection, it is the duty of the assessing officer to pass a speaking order overruling objection even before commencing section 147 proceedings.
(12)	A.O. may proceed under section 143(1) or 143(3) or 144 to complete the assessment under section 147, since return filed by the assessee will have same effect as if it is required to be filed under section 139.
(13)	During the course of proceedings under section 147, if any other income which has escaped assessment and which comes to the notice of assessing officer, then same can also be included while passing order under section 147.
(14)	Assessing officer shall ensure that order under section 147 shall be passed within 9 months from the end of financial year in which notice under section 148 is served. (Section 153).

20.29 PROTECTIVE ASSESSMENT

- There is no specific provision in the Indian Income-tax Act for such a thing as protective assessment.
- But it is permissible to make a protective assessment, where owing to litigations it is not possible to establish finally as to who is the proper assessee.
- The reason for protective assessment is that if the income-tax authorities are precluded from making an alternative assessment, then, by the time the disputes are over, the real assessment would be barred.
- But while a protective assessment is permissible, **protective recovery of tax cannot be allowed.**

Practical 14

There is a dispute with regard to ownership of house property between Mr. A and Mr. B. Dispute is pending before ordinary court. What are the courses of action available with A.O. for assessing income from disputed property?

Solution

- Alternative-1

A.O. can assess house property income in the hands of Mr. A as well as Mr. B on protective basis. However he cannot collect tax pertaining to income under the head house property.

- Alternative-2

Notice for income escaping assessment u/s 148 can be issued at any time in order to give effect to a finding given by any court in any proceedings under any law.

Readers Note:

20.30 | RECTIFICATION OF MISTAKES BY I.T. AUTHORITY OF ANY ORDER OR INTIMATION**Section:- 154****Section 154(1)**

With a view to rectifying **any mistake apparent from the record** an income-tax authority referred to in section 116 may,

- (a) amend any order passed by it under the provisions of this Act ;
- (b) amend any intimation or deemed intimation under sub-section (1) of section 143.
- (c) amend any intimation issued under sub-section (1) of section 200A
- (d) amend any intimation issued under sub-section (1) of section 206CB.

Section 154(1A)

Where any matter has been considered and decided in any proceeding by way of appeal or revision relating to an order referred to in sub-section (1), the authority passing such order may, notwithstanding anything contained in any law for the time being in force, amend the order under that sub-section in relation to any matter other than the matter which has been so considered and decided.

Section 154(2)

Subject to the other provisions of this section, the authority concerned

- (a) may make an amendment under sub-section (1) of its own motion, and
- (b) shall make such amendment for rectifying any such mistake which has been brought to its notice by the assessee or by the deductor or collector, and where the authority concerned is the Commissioner (Appeals), by the Assessing Officer also.

Section 154(3)

An amendment, which has the effect of enhancing an assessment or reducing a refund or otherwise increasing the liability of the assessee or deductor or collector, shall not be made under this section unless the authority concerned has given notice to the assessee or deductor or collector of its intention so to do and has allowed the assessee or deductor or collector a reasonable opportunity of being heard.

Section 154(4)

Where an amendment is made under this section, an order shall be passed in writing by the income-tax authority concerned.

Section 154(5)

Where any such amendment has the effect of reducing the assessment or otherwise reducing the liability of the assessee or the deductor or collector, the Assessing Officer shall make any refund which may be due to such assessee or the deductor or collector.

Section 154(6)

Where any such amendment has the effect of enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee or the deductor or collector, the Assessing Officer shall serve on the assessee or the deductor or collector, as the case may be a notice of demand in the prescribed form specifying the sum payable, and such notice of demand shall be deemed to be issued under section 156 and the provisions of this Act shall apply accordingly.

Section 154(7)

No amendment under this section shall be made **after the expiry of four years from the end of the financial year in which the order sought to be amended was passed.**

Section 154(8)

Without prejudice to the provisions of sub-section (7), where an application for amendment under this section is made by the assessee or by deductor or collector to an income-tax authority, the authority shall pass an order, within a period of six months from the end of the month in which the application is received by it,

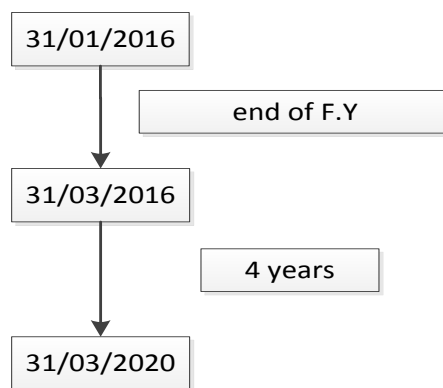
- (a) making the amendment; or
- (b) refusing to allow the claim.

Practical 15

For **A.Y. 2014-15**, Assessing Officer passed the order u/s 143(3) on **31/01/2016**. In this order, the assessing officer found the mistake apparent from record. Ascertain the maximum time limit available with assessing officer to rectify this order.

Solution

Time limit under Section 154(7): When A.O. acting on his own motion

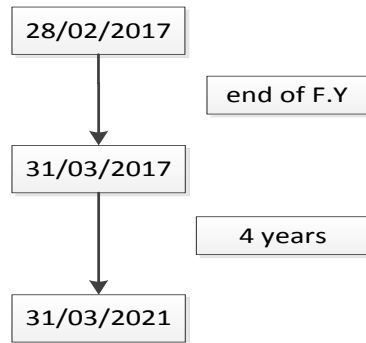
**Readers Note:****Practical 16**

For **A.Y. 2015-16**, Assessing Officer completed the assessment under u/s 143(3) on **28/02/2017**. In this order, the assessee found the mistake apparent from record. Ascertain the maximum time limit by which assessee can submit an application (request) for rectification to the assessing officer.

Assuming that the assessee submitted application for rectification on **10/06/2018**, what shall be the maximum time limit by which the assessing officer shall dispose of this application?

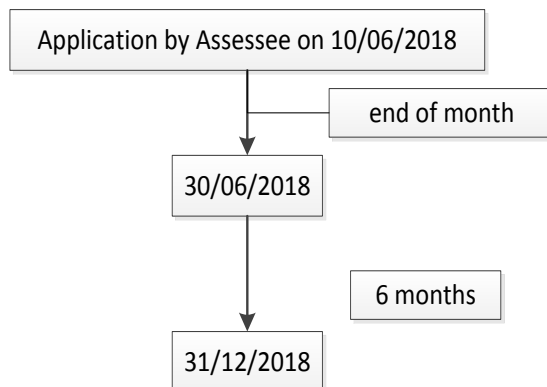
Solution**(1) Time limit for submitting an application to the assessing officer:**

Readers must note that on analysis of **Circular No. 73, dated 7-1-1972**, assessee can make an application within 4 years from the end of financial year in which order sought to be amended was passed. In that case, the departmental authority shall dispose of this application within the time frame given under section 154 (8).



Therefore, the assessee can make an application for rectification on or before **31/03/2021**.

(2) Time limit under Section 154(8): When Assessee makes an application



The assessing officer shall dispose of the application of the assessee under section 154 either approving or refusing on or before **31/12/2018**.

Readers Note:

Practical 17

Whether following result into mistake apparent from record?

- (i) Debatable point of law
- (ii) Subsequent Supreme Court Decision
- (iii) Retrospective Amendment

Solution

(i) Debatable point of law

The Supreme Court in the case of **T. s. Balaram, ITO v. Volkart Bros 82 ITR 50**, held that “a mistake apparent on the record must be an obvious and patent mistake and not something which can be established by a long-drawn process of reasoning on points on which there may be conceivably two opinions.

Therefore, a decision on a debatable point of law is not a mistake apparent from the record.

(ii) Subsequent Supreme Court Decision

The Andhra Pradesh High Court in case of **B.V.K. Seshavataram v. CIT 210 ITR 633** held that “A subsequent decision of Supreme Court can validly form basis for rectifying an order of assessment under section 154 provided decision is given by the Apex Court within **four years from the end of the financial year in which the order sought to be amended was passed**.

Therefore, a subsequent Supreme Court decision result into mistake apparent from record for the purpose of section 154. CBDT has also expressed similar view in circular No. 68 dated November 17, 1971.

(iii) Retrospective Amendment

The Calcutta High Court in case of **CIT v. E.Sefton and Co. (P.) Ltd. (1989) 179 ITR 435** held that if the assessment order is plainly and obviously inconsistent with the specific and clear provision as amended retrospectively, undisputedly there is a mistake apparent from record.

Therefore, in the light of the retrospective amendment, the assessment order had to be rectified /amended under section 154.

Readers Note:

Practical 18

In an order of assessment for the **A.Y. 2013-14**, the assessee noticed a mistake for which application u/s 154 was moved and the order was rectified. Subsequently, the assessee moved further application for rectification u/s 154 which was rejected by the Assessing Officer on the ground that the order once rectified cannot be rectified again. Is the contention of the Assessing Officer correct?

Solution

The word “order” in expression “from the end of the financial year in which the order sought to be amended” in section 154(7) includes amended or rectified order and, therefore, where original assessment was subsequently rectified, a second application for rectification can be made.— **Hind Wire Industries Ltd. v. CIT 212 ITR 639 (1995) (SC)**

Readers Note:

21 - APPEALS

21.1 APPELLATE TRIBUNAL

Section:- 252

- The Central Government shall constitute an Appellate Tribunal consisting of as many judicial and accountant members as it thinks fit to exercise the powers and discharge the functions conferred on the Appellate Tribunal.
- A judicial member shall be a person-
 1. who has held a judicial office in the territory of India at least for ten years; or
 2. who has been a member of the Indian Legal Service and has held a post in Grade II of that service or any equivalent or higher post for at least three years; or
 3. who has been an advocate for at least 10 years.
- An accountant member shall be a person -
 1. who has been in the practice of accountancy as a Chartered Accountant at least for ten years; or
 2. who has been a member of the Indian Income-tax Service. Group A and has held the post of Additional Commissioner of Income Tax or any equivalent or higher post for at least three years.
- The Central Government shall appoint—
 - (a) a person who is a sitting or retired Judge of a High Court and who has completed not less than seven years of service as a Judge in a High Court; or
 - (b) one of the Vice-Presidents of the Appellate Tribunal, to be the President thereof.

21.2 APPEALS TO TRIBUNAL

Section:- 253

• Appealable Orders

(A) Appeal by assessee [Section 253(1)]

- An order passed by a Commissioner (Appeals) u/s 154, section 250, section 271, section 271A, section 271J or section 272A or
- An order passed by a Commissioner under section 12AA or u/c (vi) of section 80G(5) or under section 263 [or section 271 (w.e.f. 1-6-2002)] or under sections 272A or an order passed by him under section 154 amending his order under section 263 or an order passed by a Chief Commissioner or a Director General or a Director under section 272A
- An order passed by Assessing Officer under section 115VZC(1)-Expulsion from Tonnage Taxation Scheme.
- An order passed by an Assessing Officer under section 143(3) or section 147 or section 153A or section 153C in pursuance of the directions of the Dispute Resolution Panel or an order passed under section 154 in respect of such order.
- An order passed by the prescribed authority under Section 10(23C) (iv) or (v) or (vi) or (via).

(B) Appeal by Commissioner [Section 253(2)]

Order passed by Commissioner (Appeals) under section 154 or 250.

- **Time limit for presenting appeal [Section 253(3)]**

Within 60 days of the date on which order sought to be appealed against is communicated to the assessee/Commissioner.

- **Form of Appeal, Filing Fees, Signing of Form and Documents to be submitted [Section 253(6)]**

- The appeal shall be presented in Form No. 36.
- It shall be signed and verified by the person authorized to sign the return of income under section 140.
- Documents to be submitted:
 - (a) Form No. 36- 2 copies
 - (b) Order appealed against – 2 copies (including one certified copy)
 - (c) Order of Assessing Officer – 2 copies
 - (d) Grounds of appeal before first appellate authority – 2 copies
 - (e) Statement of facts filed before first appellate authority – 2 copies
 - (f) In case of appeal against penalty order -2 copies of relevant assessment order.
 - (g) In case of appeal against order under section 143(3), read with section 144A - 2 copies of the directions of the Deputy Commissioner under section 144A.
 - (h) In case of appeal against order under section 143(3), read with section 144B - 2 copies of the draft assessment of the Deputy Commissioner under section 144B.
 - (i) In case of appeal against order u/s 143(3), read with section 147-2 copies of original assessment order, if any.
 - (j) Triplicate copy of challan for payment of fee.
- Above documents shall be accompanied by a prescribed fee as follows:

Particulars	Rs.
(1) Assessed total income of Rs.1 lakh or less	500
(2) Assessed total income is more than Rs. 1 lakh but less than Rs.2 lakh	1,500
(3) Appeals involving total income more than Rs.2 lakh	1% of the assessed income subject to a maximum of Rs.10,000
(4) Miscellaneous applications under 254(2)	50
(5) Stay petitions [Section 253(7)]	500
(6) Any other matter	500

- **Time limit for filing of cross-objections [Section 253(4)]**

On receipt of notice from the Registrar of Tribunal intimating that an appeal against the order of CIT (A) has been preferred under section 253(1) or 253(2) by the other party, the Assessing Officer or the assessee may file a memorandum of cross-objections within 30 days from the date of receipt of such notice.

It shall be in Form No. 36A. No fee is required to be paid for filing such memorandum of cross objection.

Once memorandum of cross-objection is filed within the time limit, it shall be disposed of by the Tribunal as if it were an appeal.

- **Condonation of delay in filing appeal [Section 253(5)]**

The Tribunal may admit an appeal / memorandum of cross-objection after the expiration of the prescribed period, if it is satisfied that there was sufficient cause for not presenting it within that period.

21.3 ORDERS OF APPELLATE TRIBUNAL

Section:- 254

- The Tribunal may, after giving both the parties to the appeal an opportunity of being heard, pass such orders as it thinks fit.
- The Tribunal shall send a copy of any order passed to the assessee and to the Principal Commissioner or Commissioner.
- Cost of appeal shall be at discretion of Tribunal.
- The appeal, where it is possible, shall be disposed within a period of four years from end of financial year in which appeal is filed. – **Section 254(2A)**
 - Appellate Tribunal may, after considering the merits of the application made by the assessee, pass an order of stay in any proceedings relating to an appeal filed under sub-section (1) of section 253, for a period not exceeding one hundred and eighty days from the date of such order and the Appellate Tribunal shall dispose of the appeal within the said period of stay specified in that order :- **First Proviso to Section 254(2A)**
 - Where such appeal is not so disposed of within the said period of stay as specified in the order of stay, the Appellate Tribunal may, on an application made in this behalf by the assessee and on being satisfied that the delay in disposing of the appeal is not attributable to the assessee, extend the period of stay, or pass an order of stay for a further period or periods as it thinks fit; so, however, that the aggregate of the period originally allowed and the period or periods so extended or allowed shall not, in any case, exceed three hundred and sixty-five days and the Appellate Tribunal shall dispose of the appeal within the period or periods of stay so extended or allowed: **-Second Proviso to Section 254(2A)**
 - Provided also that if such appeal is not so disposed of within the period allowed under the first proviso or the period or periods extended or allowed under the second proviso, the order of stay shall stand vacated after the expiry of such period or periods, even if the delay in disposing of the appeal is not attributable to the assessee. – **Third Proviso to Section 254(2A)**

Practical 1

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 **01.01.2017**. The bench could not function thereafter till **01.02.2018** and therefore, the disputed matter could not be disposed off. The Assessing Officer attached the bank account on **16.02.2018** and recovered the amount of Rs.15 lacs against the arrear demand of Rs.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.

Solution

As mentioned in the first, second and third proviso to section 254(2A), the stay granted by the Appellate Tribunal shall stand vacated after the period of 365 days, inspite of the delay is not due to assessee.

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 Rs.15 lacs against the arrear demand of Rs. 25 lacs made by the Assessing Officer is a valid action.

Readers Note:

21.4 FEW CASE STUDIES WITH REGARD TO RESTRICTION ON POWER OF TRIBUNAL

Section:-

The Tribunal cannot grant relief larger than what was prayed for in the appeal—**CIT v. Krishna Mining Co. (AP)**.
Tribunal is not authorised to take back the benefit granted to the assessee by the Assessing Officer -
Hukumchand Mills Ltd. v. CIT 63 ITR 232 (SC)

21.5 RECTIFICATION OF MISTAKES BY TRIBUNAL

Section:- 254(2)

- The Tribunal may, at any time within 4 years from the date of the order (with effect from 1st June, 2016, six months from the end of the month in which the order was passed), with a view to rectifying any mistake apparent from the record, amend any order passed by it and shall make such amendment if the mistake is brought to its notice by the assessee or the Assessing Officer.
- If, however, an amendment has the effect of enhancing an assessment or reducing a refund or otherwise increasing the liability of the assessee, it shall not be made unless the Tribunal has given notice to the assessee of its intention to do so and has allowed the assessee a reasonable opportunity of being heard.

Practical 2

Give few examples of “Mistake apparent from record” which can be rectified by Tribunal?

Solution

- Arithmetical error
- Subsequent Supreme Court decision
- Retrospective Amendment
- Non-consideration of Judgment cited before it
- Non-disposal of grounds of appeal
- Procedural lapse on the part of Tribunal like failure to refer matter to president when there is a disagreement between Accountant Member and Judicial Member
- Overlooking the material facts on record

Readers Note:

Practical 3

Can Tribunal Review its own order? Or Can Tribunal Re-decide / recall the matter?

Solution

On the analysis of various judgments of High Courts and the Supreme Court, the following principles emerge with regard to the powers of the Tribunal to rectify and review its own order:

1. The power of the Tribunal under section 254(2) is confined to rectifying any mistake apparent from the record.
2. If the error or mistake is one, which could be established only by long-drawn arguments or by way of process of investigation and research, it is not a mistake apparent from the record.
3. The Tribunal cannot re-decide the matter and it has no power to review its order.
4. Where the Tribunal has over-looked the relevant material on record, there would be an error apparent from record, which can be rectified by setting aside the order for fresh consideration.

Readers Note:

21.6 | FUNCTIONING OF TRIBUNAL**Section:- 255****Section 255(2)**

Normally, a Bench of the Appellate Tribunal shall consist of one Judicial Member and one Accountant Member.

Section 255(3)

The President or a member of the Appellate Tribunal may be empowered by the Central Government, sitting singly, to dispose of any case where total income assessed does not exceed Rs.15 lakhs. (Rs. 50 lakh with effect from 01.06.2016). The President may constitute a Special Bench consisting of three or more members, one of whom shall be a judicial member and one on accountant member.

Section 255(4)

If the members of a Bench differ in opinion on any point, the point shall be decided according to the opinion of the majority. If the members are equally divided, they shall state the point or points on which they differ, and the case shall be referred by the President for hearing by one or more of the other members of the Appellate Tribunal. Such point shall thereafter be decided according to the opinion of the majority of the members of the Appellate Tribunal who have heard the case, including those who first heard it.

21.7 | PRODUCTION OF ADDITIONAL EVIDENCE BEFORE INCOME TAX APPELLATE TRIBUNAL**Rule:-** Rule 29 of Appellate Tribunal Rules, 1963

The parties to the appeal shall not be entitled to produce additional evidence, either oral or documentary, before the Tribunal. However, the following are the exceptions to this rule –

- (a) where the Tribunal requires any document to be produced or any witness to be examined or any affidavit to be filed to enable it to pass orders or for any other substantial cause; or
- (b) where the income-tax authorities have decided the case without giving sufficient opportunity to the assessee to adduce evidence either on points specified by them or not specified by the them.

In case of (a) above, the Tribunal may allow such document to be produced or witness to be examined or affidavit to be filed.

In case of (b) above, the Tribunal may allow such evidence to be adduced.

However, in both cases, the Tribunal should record its reasons in writing.

21.8 | APPEAL TO HIGH COURT**Section:- 260A**

Who can file appeal	Assessee or Chief Commissioner / Commissioner
Order against which appeal to High Court is possible	Any order passed in appeal by the Appellate Tribunal, if the High court is satisfied that the case involves a substantial question of law .
Time limit for filing appeal	120 days from the date on which order of Tribunal is received by the assessee or the Chief Commissioner or Commissioner. Further, the High Court may admit an appeal after the expiry of the period of 120 days, if it is satisfied that there was sufficient cause for not filing the appeal within 120 days.

Other important issues	• The appeal shall be in form of a memorandum of appeal, precisely stating the substantial question of law involved in the appeal. • Where the High Court is satisfied that a substantial question of law is involved, it should formulate the question. • Where the High Court delivers a judgement, effect shall be given to order passed by AO on basis of certified copy of judgement. • The appeal to be heard only on the question to be formulated (however, the Court has the power to hear, for reasons to be recorded, the appeal on any other substantial question of law not formulate by it, if it is satisfied that the case involves such question). • High Court can award such costs as it deems fit. • The High Court may determine any issue which- ➤ has not been determined by the Appellate Tribunal; or ➤ has been wrongly determined by the Appellate Tribunal. • The appeal is to be heard by a bench of not less than 2 judges of the High Court and decision will be in accordance with opinion of majority of judges. • Where judges are equally divided in their opinions, the case on the point on which they differ shall be heard by one or more other judges of the High Court. • The section 260A(7) provides that the provisions of the Code of Civil Procedure, 1908 relating to appeals to the High Court shall apply in the case of appeals under this Act.

Practical 4

An appeal may lie before High Court only when “Substantial question of law” is involved in the matter. In this context, explain the meaning of term “Substantial question of law”.

Solution

The expression ‘substantial question of law’ has not been defined anywhere in the statute.

But it has acquired a definite meaning through various Court decisions. As per these decisions, five tests to be carried out.

The tests are:

- (1) Whether directly or indirectly it affects substantial rights of the parties,
- (2) the question is of general public importance,
- (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,
- (4) the issue is not free from difficulty, and
- (5) it calls for a discussion for alternative view.

Readers Note:

Practical 5

"The High Court cannot interfere with the factual finding recorded by the lower authorities and the tribunal, without any valid reasons"-Comment.

Solution

- The Income-tax Appellate Tribunal is a final fact finding authority. Such finding of fact cannot be disturbed by the High Court in exercise of its powers under section 260A.

- However, in following cases, finding of fact recorded by Tribunal can be interfered with by the High Court under section 260A.
 - If such finding were without evidence or material, or
 - If the finding is contrary to the evidence, or is perverse or
 - If 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 **Commissioner of Agricultural income-tax vs. M.N.Moni (2007) 291 ITR 387**, the Supreme 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 further 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.

Readers Note:

Practical 6

Does the High Court have the inherent power under the Income-tax Act, 1961 to review its own order on merits?

Solution

- The Supreme Court in case of **CIT v. Meghalaya Steels Ltd. (2015) 377 ITR 112** 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, while dealing with power of review of writ petitions filed under article 226, the Supreme Court, in another case, 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.
- The Supreme Court further observed 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.

Readers Note:

21.9 THE IMPACT OF SUPREME COURT DECISION IN CASE OF SATISH SHAH, MONETARY LIMITS FOR NOT FILING APPEAL AND THE PROVISIONS OF SECTION 268A.

Section:- 268A

Department accepted decision rendered by High Court in one case and didn't file an appeal to Supreme Court. Later, the high court rendered similar decision in another case following earlier decision. Supreme Court in case of **UOI vs. Satish Shah 249 ITR 221** held that the department having accepted earlier judgment is not entitled to challenge the decision in later case before Supreme Court.

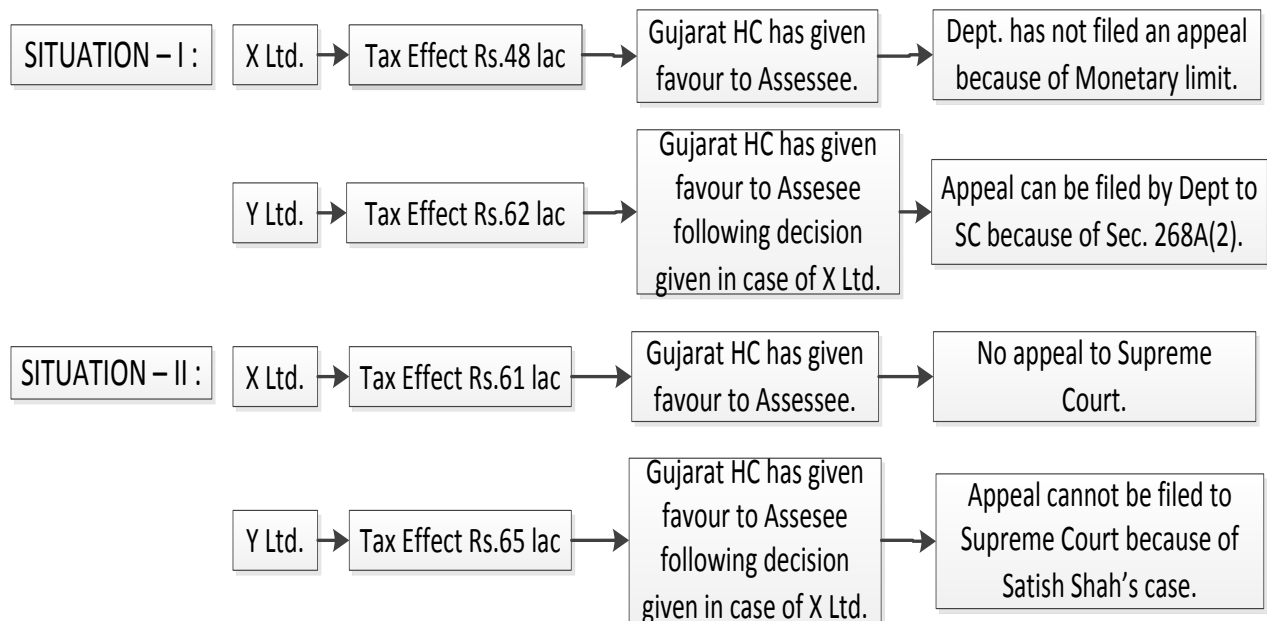
The Central Board of Direct Taxes have issued instructions from time-to-time directing departmental officers not to file an appeal if the tax effect is less than the monetary limit prescribed by it. At present following monetary limits are in force:-

Limit

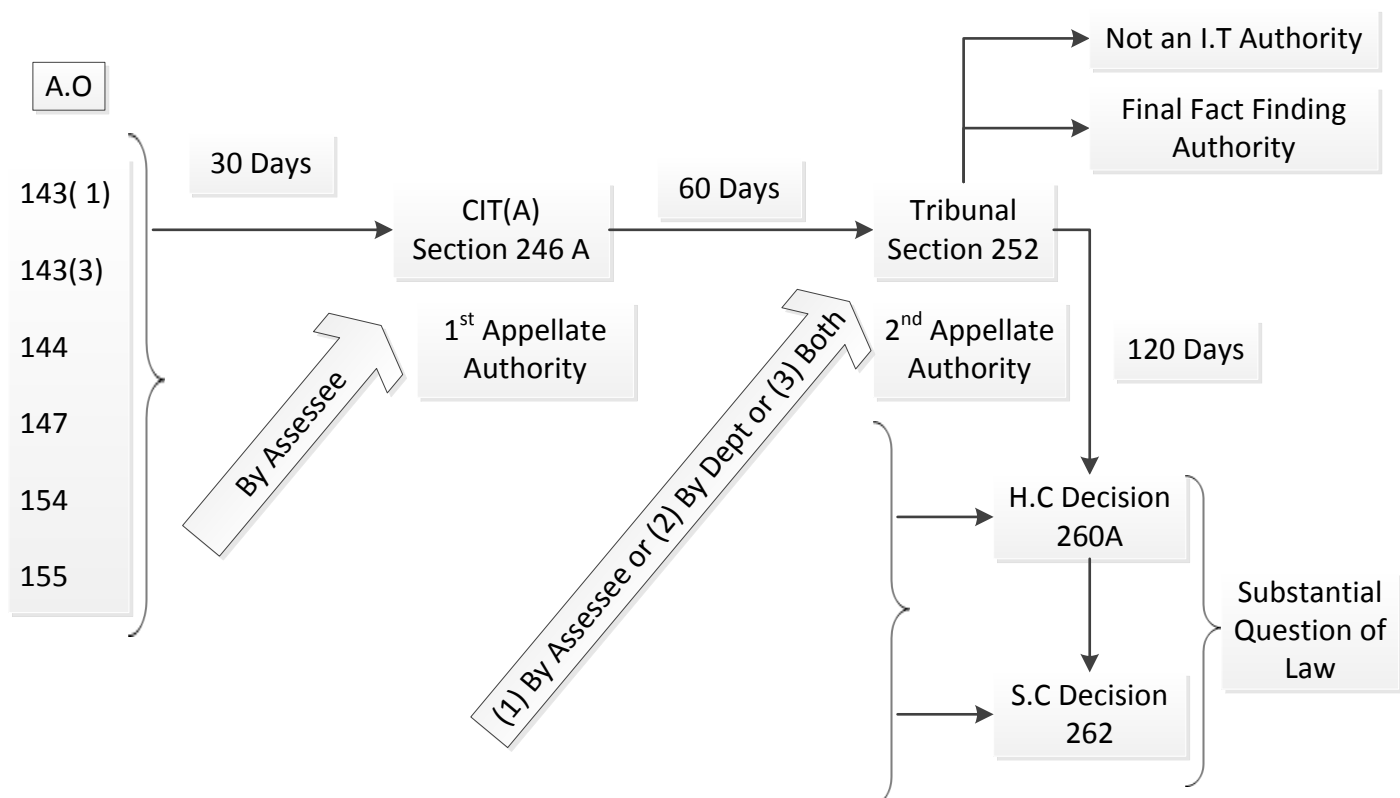
1. Appeal to Tribunal	-	Rs. 20,00,000
2. Appeal to High Court	-	Rs. 50,00,000
3. Appeal to Supreme Court	-	Rs. 1,00,00,000

With a view to protecting revenue's right to file an appeal, a new section 268A has been inserted with retrospective effect from April 1, 1999 which reads as under:

- (1) The Board may issue orders, instructions or directions to other income-tax authorities, fixing such monetary limits as it may deem fit. Such fixing monetary limit is to be for the purpose of regulating filing of an appeal or an application for reference by any income-tax authority under the provisions of the Act.
- (2) Where an income-tax authority has not filed an appeal or application for reference on any issue in the case of an assessee for any assessment year, due to above-mentioned order/instructions / direction of the Board, such authority shall not be precluded from filing an appeal or an application for reference on the same issue in the case of-
 - a. The same assessee for any other assessment year or
 - b. Any other assessee for the same year or any other assessment year
- (3) Where no appeal or application for reference has been filed by an income-tax authority pursuant to abovementioned orders / instructions / directions of the Board, 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 an application for reference in respect of any case.
- (4) The Appellate Tribunal or Court shall have regard to the above-mentioned orders / instructions / directions of the Board and the circumstances under which such appeal or application for reference was filed or not filed in respect of any case.

Combined effect of monetary limit, Section 268A and Satish Shah's Case.

Summary Chart of provisions relating to Appeals



22 - REVISION BY PRINCIPLE COMMISSIONER OR COMMISSIONER

22.1 REVISION OF ORDERS PREJUDICIAL TO THE INTEREST OF REVENUE

Section:- 263

Orders which may be revised	Any order passed by the Assessing Officer which the Principal Commissioner or Commissioner considers erroneous in so far as it is prejudicial to the interests of the revenue.
Explanation 1(a) to Section 263	For the purpose of this section, order passed by the Assessing Officer shall include: (i) an order of assessment made by the Assistant Commissioner or Deputy Commissioner or the Income-tax Officer on the basis of the directions issued by the Joint Commissioner under section 144A; (ii) an order made by Jt. CIT in the capacity of A.O.
Explanation 1(b) to Section 263	For the purpose of this section, "record" shall include and shall be deemed always to have included all records relating to any proceeding under this Act available at the time of examination by the Principal Commissioner or Commissioner.
Can order which are the subject-matter of appeal be revised? -Explanation 1(c) to section 263	In the case of orders which have been the subject-matter of appeal, the Commissioner can use his power under this section and revise the orders in relation to such matters as had not been considered and decided in such appeal.
Explanation 2 to section 263 [Inserted by FA 2015 with effect from 01.06.2015]	For the purposes of section 263, it is hereby declared 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,— (a) the order is passed without making inquiries or verification which should have been made; (b) the order is passed allowing any relief without inquiring into the claim; (c) the order has not been made in accordance with any order, direction or instruction issued by the Board under section 119; or (d) the order has not been passed in accordance with any decision which is prejudicial to the assessee, rendered by the jurisdictional High Court or Supreme Court in the case of the assessee or any other person.
Procedure to be followed	First, the Commissioner may call for and examine the record of any proceeding under the Act.
	If the Commissioner finds any order passed by the Assessing Officer to be erroneous and prejudicial to the interests of the revenue, he must give an opportunity to the assessee of being heard.
	He must also make or cause to be made such enquiry as he deems necessary
	Thereafter he may pass such revision order as the circumstances of the case justify (including an order enhancing or modifying the assessment, or canceling the assessment and directing a fresh assessment)

Time limit for passing revision order	Two years from the end of the financial year in which the order sought to be revised was passed (however, there is no time limit for passing an order to give effect to, or in consequence of, an order of the ITAT, the High Court or the Supreme Court).

22.2 REVISION IN FAVOUR OF ASSESSEE

Section:- 264

Orders which may be revised	Orders other than orders to which section 263 applies passed by an authority subordinate to the Commissioner
On whose motion is revision possible	Either on the Commissioner's own motion or on an application by the assessee for revision
Procedure to be followed	- Once revision proceedings have been initiated, the Commissioner may call for and examine the record of any proceeding under the Act in which the order to be revised has been passed. - He must then make or cause to be made such enquiry as he deems necessary. - Thereafter, he may pass such revision order as the circumstances of the case justify. However, the order passed should not be prejudicial to the assessee.
Time Limit	- Commissioner while acting on his motion: One year from the date of original order. - Where revision has been initiated by assessee, the application must be made within one year from the date on which the order in question was communicated to the assessee or the date on which he otherwise came to know of it, whichever is earlier. However, the Commissioner can admit a belated application if the assessee was prevented by sufficient cause from making the application within time. - Where the application is made by the assessee, the Commissioner is required to pass an order within one year from the end of the financial year in which the application is made.
Cases where orders cannot be revised. Section 264(4)	- Where an appeal lies to the First or Second appellate authority but has not been made and the time within which the appeal may be made has not expired, or in the case of an appeal to the Commissioner (Appeals) or the ITAT, the assessee has not waived his right of appeal; or - Where the order is an appeal before the Commissioner (Appeals) or the ITAT.

22.3 DOCTRINE OF PARTIAL MERGER VS. TOTAL MERGER

• DOCTRINE OF PARTIAL MERGER:

This doctrine holds good for the following sections:

Section	Relevant Provision
Third proviso to Section 147	Assessing Officer may assess or reassess such income, other than the income involving matters which are the subject matters of any appeal, reference or revision, which is chargeable to tax and has escaped assessment.

Section 154(1A)	Similar restriction like third proviso to section 147, while carrying out rectification of mistake apparent from record.
Explanation 1(c) to Section 263(1)	Where any order passed by the Assessing Officer had been the subject matter of any appeal, the powers of the Principal Commissioner or Commissioner under section 263(1) shall extend to such matters as had not been considered and decided in such appeal.

- **DOCTRINE OF COMPLETE MERGER:**

This doctrine is relevant for section 264 of the Act.

As per the provisions of section 264(4) of the Act, the Principal Commissioner or Commissioner shall not revise the order passed by the subordinate authority, where such order has been made the subject of an appeal to CIT(A) or to the Appellate Tribunal.

23 - ASSESSMENT ON REMAND

23.1 TIME LIMIT FOR COMPLETION OF FRESH ASSESSMENT

Section:- 153(3)

If fresh assessment is made in pursuance of an order under sections 254, 263 or 264 setting aside or canceling an assessment, then, the below mentioned time limit under section 153(3) of the Act is applicable:

Nature of order	Time-limit for completion of "Fresh Assessment"
If assessment is set aside or cancelled by virtue of an order under section 254	Fresh assessment shall be completed within 9 months from the end of the financial year in which order u/s 254 is received by the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner, as the case may be.
If assessment is set aside or cancelled by virtue of an order under section 263 or 264	Fresh assessment shall be made within 9 months from the end of the financial year in which order under section 263 or 264 is passed by the Principal Commissioner or Commissioner.
During the course of the proceedings for the fresh assessment of total income if a reference under sub-section (1) of section 92CA is made	Then above time limits shall be extended by 12 months i.e. 21 months instead of 9 months.

The above time limit has been modified by the **Finance Act, 2017** in respect of above orders either passed by or received by Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner on or after 1st April 2019. In this situation, time limit of 9 months mentioned above shall be substituted by 12 months and 21 months shall be substituted by 24 months.

Practical 1

The assessments of Samip Chemicals Ltd. for the assessment year **2015-16** was completed under section 143(3). The Principal Commissioner found the order of assessing officer erroneous and prejudicial to the interest of revenue since it was passed without conducting any inquiry. The Principal Commissioner, therefore, while acting under section 263 of the Act, set aside the whole assessment order and directed the assessing officer to pass the order afresh. This order of Principal Commissioner was dated **10-07-2018**.

Based on the above facts, answer following questions:

- (a) What is the scope of assessment proceedings at the time of fresh assessment after the order of Principal Commissioner?
- (b) What is the time limit for completion of above assessment?

Solution

- (a) Considering the ratio laid down in **Kundanlal Maru v. CIT (1982) 135 ITR 84 (MP)** and the **Rambilas Chandran v. CIT (1985) 156 ITR 344**, where the Principal Commissioner sets aside the whole assessment and directs the assessing officer to pass the order afresh without imposing any restrictions or limitations as to how the fresh proceedings to be conducted by the Assessing Officer, then the Assessing Officer has the same powers in making such fresh assessment as he had originally when making an assessment under section 143(3) / 144 of the Act.
- (b) Time limit for completion of "fresh assessment" is now governed by section 153(3). Considering the provisions of this section, the assessing officer shall complete the "fresh assessment" within 12 months from the end of financial year in which order u/s 263 was passed by the Principal Commissioner.

Readers Note:

24 - INCOME TAX AUTHORITIES AND THEIR POWERS

24.1 POWER REGARDING DISCOVERY, PRODUCTION OF EVIDENCE

Section:- 131

Assessing Officer, Joint Commissioner of Income Tax, Commissioner of Income Tax (Appeals), Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner and the Dispute Resolution Panel shall have the following powers as are vested in a Court under the Code of Civil Procedure, 1908

- Discovery and inspection;
- Enforcing attendance of any person, including any officer of a banking company and examining him on oath;
- Compelling production of books of accounts and other documents; and
- Issuing commissions

The authority mentioned above may impound and retain books and documents in its custody for such period as it thinks fit.

However, the Assessing Officer/ Assistant director/ Deputy Director shall not retain books/ documents

(a) without recording reasons for doing so, or

(b) for a period exceeding 15 days (exclusive of holidays) without prior permission of Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General or Principal Commissioner or Commissioner or Principal Director or Director of Income Tax.

24.2 POWER TO CALL FOR INFORMATION

Section:- 133

The Assessing Officer, Joint Commissioner, Commissioner (Appeals) may require to furnish the following details:

Sub-Section	Assessee	Information
(1)	Firm	Names, addresses of the partners of the firms and their respective shares.
(2)	HUF	Names, addresses of the manager and the members of the family
(3)	Trustee, guardian, agent	Names of the persons for or of whom he is trustee, guardian or agents and their addresses
(4)	Any assessee	Name and addresses of persons to whom the following payments are made exceeding Rs. 1,000 or such higher amount as may be prescribed - Rent, - interest, - commission, - royalty, - brokerage, - annuity not being taxable under the head "Salaries"
(5)	Broker, agent or any person concerned in the management of stock or commodity exchange	Names and addresses of all persons to whom any sum has been paid or received for transfer by way of sale, exchange or otherwise of assets together with particulars of all such payments and receipts.
(6)	Any person, including a banking company or any officer thereof.	Statements of accounts and affairs verified in a specified manner in relation to such matters or points as, in the opinion of the authority will be useful for or relevant to any enquiry or proceedings under the Act.

However, the powers referred to in section 133(6) may also be exercised by the Principal Director General or Director-General, the Principal Chief Commissioner or Chief Commissioner, the Principal Director or Director and the Principal Commissioner or Commissioner or **the Joint Director or Deputy Director or Assistant Director** (Bold words added by **Finance Act, 2017** w.e.f. 1st April, 2017).

Provided further that the power in respect of an inquiry, in a case where no proceeding is pending, shall not be exercised by any income-tax authority below the rank of Principal Director or Director or Principal Commissioner or Commissioner **other than the Joint Director or Deputy Director or Assistant Director** (Bold words added by **Finance Act, 2017** w.e.f. 1st April, 2017) without the prior approval of the Principal Director or Director or, as the case may be, the Principal Commissioner or Commissioner.

24.3 POWER TO SURVEY

Section:- 133A

• Survey in connection with business or profession [Section 133A(1)]

(i) Place of survey:

- a) Any place within the limits of the area assigned to the income tax authority,
- b) Any place occupied by any person in respect of whom the income tax authority exercises jurisdiction,
- c) any place in respect of which he is authorised for the purposes of this section by such income-tax authority, who is assigned the area within which such place is situated or who exercises jurisdiction in respect of any person occupying such place,

at which a business or profession or an activity for charitable purpose is carried on, whether such place be the principal place or not of such business or profession or **of such activity for charitable purpose** (Bold words added by **Finance Act, 2017** w.e.f. 1st April, 2017)

Explanation.—For the purposes of this sub-section, a place where a business or profession or activity for charitable purpose is carried on shall also include any other place, whether any business or profession or **activity for charitable purpose** is carried on therein or not, in which the person carrying on the business or profession or **activity for charitable purpose** states that any of his books of account or other documents or any part of his cash or stock or other valuable article or thing relating to his business or profession or **activity for charitable purpose** are or is kept. (Bold words added by **Finance Act, 2017** w.e.f. 1st April, 2017)

(ii) Time to enter the place of survey:-

Place of Survey	Time of Survey
Place of business or profession	During the hours at which such place is open for the conduct of business or profession
At any other place	Only after sunrise and before sunset.

(iii) Rights of the Income tax Authority

- (a) Inspect books of accounts or other documents available at such place and impound and retain in his custody books of account or other documents inspected by him after recording his reasons for so doing. However, such books of account or other documents shall not be retained for more than 15 days (exclusive of holidays) without obtaining the approval of the Principal Chief Commissioner or Chief Commissioner of Income-tax or the Principal Director General or Director-General or Principal Commissioner or the Commissioner or the Principal Director or the Director.
- (b) make inventory of the cash, stock, or other valuable article or thing found therein.
- (c) Record statement of any person, which may be useful or relevant to any proceedings under this Act.

(d) Place marks of identification on books of accounts/ other documents inspected by the I. T. Authority

(iv) **Duties of the proprietor, employee or any other person available at the time of survey:**

Afford necessary facility to the surveying official:

- (a) To inspect such books of accounts and other documents as they require and which may be available at such place.
- (b) To check or verify cash, stock or other valuable article or thing which may be found therein.
- (c) Furnish such information as he may require which may be helpful for or relevant to any proceeding under the Act.

Practical 4

The Assessing Officer within his jurisdiction surveyed a popular Cyber Cafe at 12 o'clock in night for the purpose of collecting information which may be useful for the purposes of the Income-tax Act, 1961. The Cyber Cafe is kept open for business every day between 2 p.m. and 2 a.m. The owner of the Cyber Cafe claims that the Assessing Officer could not enter the cafe in late night.

Solution

The Assessing Officer is empowered under section 133A to enter any place of business of the assessee within his jurisdiction only during the hours at which such place is open for the conduct of business.

In the case given, the cyber cafe is open from 2.00 p.m. to 2.00 a.m. for the conduct of business. The Assessing Officer entered the cyber cafe at 12 o'clock in the night which falls within the working hours of the cyber cafe. Therefore, the claim made by the owner to the effect that the Assessing Officer could not enter the cyber cafe at late night is not in accordance with law.

Readers Note:

Practical 5

Can survey proceedings be continued after business hours?

Solution

Where survey is conducted at business premises, entry into the business premises must be during business hours but survey operations can continue after business hours. - **N.K. Mohnot Vs. Dy. CIT (Mad) 215 ITR 275.**

Readers Note:

24.4 INQUIRY BY PRESCRIBED INCOME-TAX AUTHORITY

Section:- 133C

This section provides that the prescribed income-tax authority, may for the purposes of verification of information in its possession relating to any person, issue a notice to such person requiring him, on or before a date to be specified therein, to furnish information or documents (verified in the manner specified therein), which may be useful for, or relevant to, any inquiry or proceeding under the Act.

For this purpose, the Board may make a scheme for centralised issuance of notice and for processing of information or documents and making available the outcome of the processing to the Assessing Officer. (inserted by Finance Act, 2017 w.e.f. 1-4-2017)



EXPLANATION 2 TO SECTION 147 : ONE OF THE CASES OF DEEMING ESCAPEMENT

25 - ASSESSMENT IN CASE OF SEARCH OR REQUISITION

25.1 ASSESSMENT IN CASE OF SEARCH OR REQUISITION

Section:- 153A (1)

1. This section has an overriding effect over section 139, 147, section 148, section 149, section 151 and section 153 of the Act.
2. In the case of any person, a search is initiated u/s 132 or requisition is made u/s 132A, the Assessing Officer shall issue a notice to such person requiring him to furnish a return of income in respect of each of the assessment years falling within six assessment years immediately preceding the assessment year relevant to the previous year in which such **search is conducted or requisition is made**.
3. The assessee shall furnish return of income in response to the above notice within the time period specified in the notice and the provisions of the Act shall apply as if such were a return required to be furnished under section 139 of the Act.
4. The assessing officer shall assess or reassess the total income in respect of each assessment year falling within such six assessment years.
5. Any assessment or reassessment relating to any assessment year falling within the period of six assessment years pending on the date of initiation of the search u/s 132 or making of requisition u/s 132A shall abate.
6. The income determined under this section shall be taxed at the rates or rates applicable to each of the relevant assessment years.
7. However the Central Government may by rules made by it and published in the Official Gazette (except in cases where any assessment or reassessment has abated under the second proviso), specify the class or classes of cases in which the Assessing Officer shall not be required to issue notice for assessing or reassessing the total income for six assessment years immediately preceding the assessment year relevant to the previous year in which search is conducted or requisition is made.

Notification No. 42/2012 dated 4.10.2012

In exercise of the powers conferred by section 153A and 153C, the Central Government has, through this notification, inserted a new Rule 112F which shall come into force from the 1st July, 2012.

The said Rule provides that the Assessing Officer is not required to issue notice for assessing or reassessing the total income for six assessment years immediately preceding the assessment year relevant to the previous year in which search is conducted or requisition is made, in the following cases:

- (i) where as a result of a search under section 132(1) or a requisition made under section 132A, a person is found to be in possession of any money, bullion, jewellery or other valuable articles or things, whether or not he is the actual owner of the same, and
- (ii) where, such search is **conducted or such requisition is made in the territorial area of an assembly or parliamentary constituency in respect of which a notification has been issued under section 30 read with section 56 of the Representation of the People Act, 1951, or where the assets so seized or requisitioned are connected in any manner to the ongoing election** in an assembly or parliamentary constituency.

However, this Rule is not applicable to cases where such search under section 132 or such requisition under section 132A has taken place after the hours of poll so notified

8. In respect of the search initiated under section 132 or the requisition made under section 132A on or after the 1st day April, 2017, the assessing officer is empowered to issue notice under section 153A and further empowered to assess or reassess total income for the aforementioned six assessment years and “for the relevant assessment year or years” (i.e. beyond six years).

The expression "relevant assessment year" shall mean 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 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.

However, for this purpose, following conditions must be satisfied:

- (i) 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 4 assessment years (which are falling beyond sixth assessment years);
- (ii) the abovementioned income has escaped assessment for such year or years;
- (iii) the abovementioned income is represented in the form of asset. For this purpose, asset shall include immovable property being land or building or both, shares and securities, loans and advances, deposits in bank account.

25.2 TIME LIMIT FOR COMPLETION OF ASSESSMENT U/S 153A

Section:- 153B

1. The time available for completion of assessment or reassessment in respect of each assessment year falling within six assessment years shall be **21 months** from the end of the financial year in which the last of the authorizations for **search** u/s 132 or for **requisition** u/s 132A was **executed**.
2. In respect of the assessment year relevant to the previous year in which search is conducted u/s 132 or requisition is made u/s 132A, a period of **21 months** from the end of the financial year in which the last of the authorizations for **search** u/s 132 or for **requisition** u/s 132A was **executed** shall be allowed.
3. The time limit mentioned at Sr. No. 1 and Sr. No. 2 has been modified by the Finance Act, 2017, the summary of which is as under:

Date where the last authorization for search under section 132 or for requisition under section 132A was executed	Abovementioned time limit of 21 months shall be substituted by:
During financial year 2018-19	18 months
During financial year commencing on or after 1 st April, 2019	12 months

4. A proviso to sub-section (1) of section 153B provides that in case of such other person, the time limit for making assessment or reassessment shall be the either:
 - (a) **21 months** from the end of the financial year in which the last of authorisations for search under section 132 or for requisition under section 132A was executed; or
 - (b) **9 months** from the end of the financial year in which books of account or documents or assets seized or requisitioned are handed over under section 153C to the Assessing Officer having jurisdiction over such other person,**whichever is later.**

5. The time limit mentioned at Sr. No. 4 has been modified by the Finance Act, 2017, the summary of which is as under:

Date where the last authorization for search under section 132 or for requisition under section 132A was executed	Abovementioned time limit of 21 months at Sr. No. 4(a) shall be substituted by:	Abovementioned time limit of 9 months at Sr. No. 4(b) shall be substituted by:
During financial year 2018-19	18 months	12 months
During financial year commencing on or after 1 st April, 2019	12 months	12 months

6. The above time limit at Sr. No. 1, 2, 3 and 4 shall be extended by further twelve months when reference is made to TPO under section 92CA (1) during the course of proceedings under this chapter.
7. For the purpose of this section, the search shall be construed to have been executed only on the conclusion of the search as recorded in the last panchanama drawn. In the case of requisition u/s 132A, the requisition shall be construed as executed only on the actual receipt of the books of account or other documents or assets by the authorised officer.

Practical 1

A search was carried out at the business premises of Ms. Mansi on **10.12.2018** and it was concluded on the same day. On conclusion of search, following documents revealed representing undisclosed income/assets pertaining to various previous years, detailed as under:

Particulars of Undisclosed Income/Assets	Amount	Relevant Previous year
Unaccounted value of investment in flat	Rs.23 lakhs	2010-11
Unaccounted value of Jewellery	Rs.28 lakhs	2009-10
Loan given to a Friend in cash represented by a promissory note	Rs.15 lakhs	2011-12
Unaccounted FDRs in various banks aggregating	Rs.12 lakhs	2013-14
Unaccounted investment in shares and securities	Rs.22 lakhs	2014-15

- Mention the six assessment years for which the Assessing Officer shall issue notice under section 153 A requiring the Mansi to file the returns.
- Can A.O. issue notice under section 153A requiring Mansi to file the returns for the A.Y. **2010-11, 2011-12** and **2012-13**?
- What will be the status of assessment proceeding of A.Y. **2017-18** which is pending on the date of search?
- For the Assessment year **2016-17**, the assessment has already been completed under section 143(3) of the I.T. Act. However, appeal is pending before the CIT(A). Discuss the impact of search on appellate proceedings which are pending on the date of search.
- What is time limit for the completion of above assessments?
- The assessing officer would like to complete the assessment of **A.Y. 2019-20** on or before **31.03.2021**. Advise the Assessing Officer.
- Ms. Mansi is unwilling to file the return. What shall be the serious consequence?

Solution

(a)	P.Y.	A.Y.
(1)	12-13	13-14
(2)	13-14	14-15
(3)	14-15	15-16
(4)	15-16	16-17
(5)	16-17	17-18
(6)	<u>17-18</u>	18-19
	10/12/18 —————→ Search Date	

- (b) In respect of the search initiated under section 132 on or after the 1st day April, 2017, the assessing officer is empowered to issue notice under section 153A for the assessment year(s) which fall(s) 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.

However, for this purpose, following conditions must be satisfied:

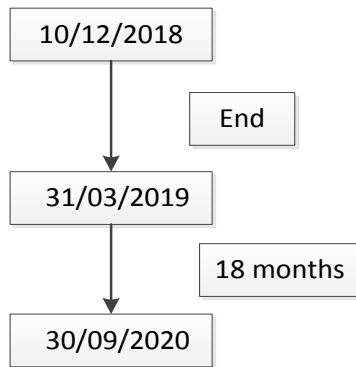
- Assessing officer has in his possession books of account or other documents or evidence which reveal that the income which has escaped assessment amounts to or is likely to amount to fifty lakh rupees or more in one year or in aggregate in the relevant 4 assessment years (which are falling beyond sixth assessment years);
- the abovementioned income has escaped assessment for such year or years;
- the abovementioned income is represented in the form of asset. For this purpose, asset shall include immovable property being land or building or both, shares and securities, loans and advances, deposits in bank account.

In the present case, four assessment years falling beyond six assessment years and corresponding escaped incomes are under:

A.Y.	Particulars of Undisclosed Income/Assets	Amount
2009-10	NO DOCUMENTS / EVIDENCE found	NIL
2010-11	Unaccounted value of Jewellery	Rs.28 lakh
2011-12	Unaccounted value of investment in flat	Rs.23 lakh
2012-13	Loan given to a Friend in cash represented by a promissory note	Rs.15 lakh
	Aggregate	Rs. 66 Lakh

Since aggregate of undisclosed income for all the four years (falling beyond six assessment years) likely to exceed Rs. 50 Lakhs, the assessing officer is empowered to issue notice under section 153A requiring Mansi to file the returns for the A.Y. **2010-11, 2011-12 and 2012-13.**

- As per the provisions of section 153A, any assessment or reassessment falling within six assessment years pending on the date of search shall abate (stop). As a result thereof, the assessment proceedings for the **A.Y. 2017-18** shall abate.
- As per the provisions of section 153A, only assessment or reassessment proceedings pending on the date of search shall abate and not the appellate proceeding. Therefore, CIT(A) can continue with appellate proceeding despite of search operations.
- As per the provisions of section 153B, the time available for completion of assessment or reassessment in respect of each assessment year falling within six assessment years shall be **18 months** from the end of the financial year in which the last of the authorizations for **search u/s 132 was executed.**

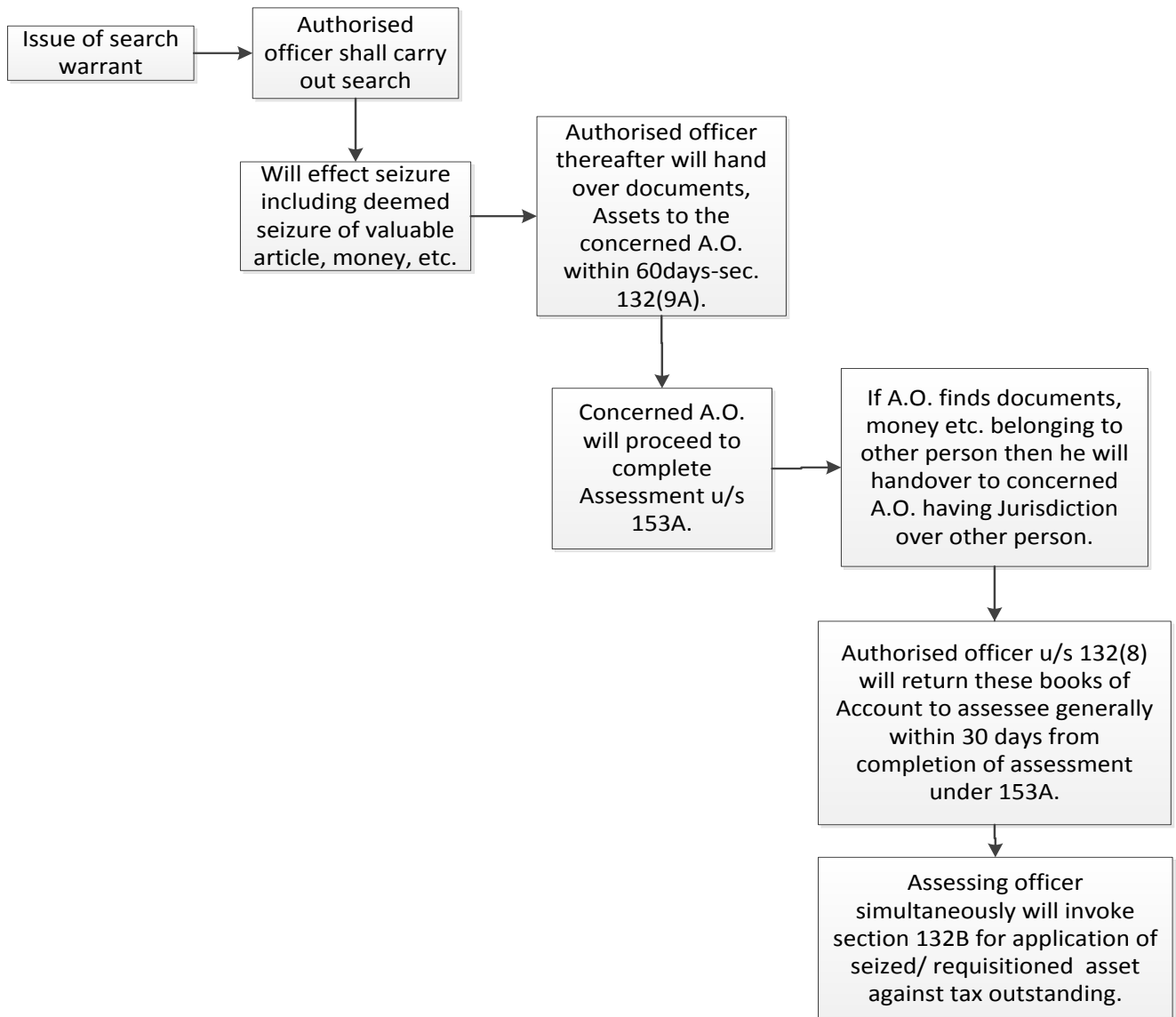


Therefore, the assessing officer shall complete the assessments in the hands of Ms. Mansi on or before **30/09/2020**.

- (f) As per the provisions of section 153B, time limit for completion of assessment for 7th A.Y. [i.e. assessment year relevant to previous year in which search is conducted] is also the same as applicable to earlier six assessment years— i.e. – **30/09/2020**. Therefore, the assessing officer is advised to adhere this time limit for completion of assessment for the **A.Y. 2019-20**.
- (g) In view of sec. 276CC, Ms. Mansi may be liable for prosecution as under
 "If a person wilfully fails to furnish in due time the return which he is required to furnish under section 153A, he shall be punishable,—
- (i) in a case where the amount of tax, which would have been evaded if the failure had not been discovered, exceeds Rs. 25 lacs, with rigorous imprisonment for a term which shall not be less than six months but which may extend to seven years and with fine;
 - (ii) in any other case, with imprisonment for a term which shall not be less than three months but which may extend to two years and with fine".

Readers Note:

Flow of Search and Seizure



26 - COLLECTION & RECOVERY OF TAX

27 - TAX DEDUCTION AND COLLECTION AT SOURCE

27.1 DEDUCTION OF TAX AT SOURCE FROM INTEREST ON SECURITIES

Section:- 193 – Modified by Finance Act, 2018 Effective from 1st April 2018

- (A) Person liable to deduct tax at source:** - Any person responsible for paying any interest on securities to a resident is required to deduct tax at source.
- (B) Time of deduction:-** Tax shall be deducted under this section, either at the time of credit to the account of the payee or at the time of payment thereof, whichever is earlier.
For this purpose, credit to “Interest payable account” or “Suspense account” or any other name shall be deemed to be a credit of such income to the account of the payee.
For this purpose, “payment” can be in cash or by issue of a cheque or draft or by any other mode.
- (C) Rate of TDS:-** 10%
- (D) Meaning of interest on securities:** Section 2(28B) defines interest on securities. It means:
- interest on any security of Central Government or State Government
 - interest on debentures or
 - interest on other securities for money issued by or on behalf of a local authority or a company or a corporation established by a Central, State or Provincial Act.
- (E) No tax is deductible in respect of interest payable on the following:**
- Debentures issued by any institution or authority or any public sector company or co – operative society (including a co – operative land mortgage bank or a co – operative land development bank) notified by the Central Government.
 - Any security of the Central / State Government. However, TDS shall be made in respect of interest exceeding Rs. 10,000 during the year on 8% Savings (Taxable) Bonds, 2003 **or 7.75% Savings (Taxable) Bonds, 2018. [Inserted by the Finance Act, 2018 w.e.f. 01-04-2018]**
 - Any listed security in dematerialized form.
 - Debentures (whether listed or not) issued by a company in which the public are substantially interested subject to following conditions:-
 - such interest is payable to an individual or Hindu Undivided family;
 - the interest is paid by the company by an account payee cheque; and
 - the aggregate amount of interest paid or likely to be paid by the company during the financial year **does not exceed Rs.5,000.**
 - Securities beneficially owned by LIC or the GIC or any other insurer.
 - Securities owned by the fund established for the benefit of armed forces. Circular No.735, 30-01-1996.
 - Securities owned by the provident fund whose income is exempt under section 10(25)(ii):- Circular No. 741, 18-04-1996.

Practical 1

Discuss whether tax is liable to be deducted at source in the following circumstances. If so, compute the amount of tax to be deducted.

- Interest of Rs. 4,000 paid by ABC Ltd. to Mr. Mohan and Rs. 4,800 to Mohan’s HUF by way of account payee cheque on account of debentures of the company held by them separately. ABC Ltd. is a company in which public are substantially interested. Debentures of ABC Ltd. are listed.
- Interest of Rs.4,800 paid by BBC Ltd. to Ms. Mohini by way of account payee cheque on account of debentures of the company held by her. BBC Ltd. is a company in which public are substantially interested.

However, its debentures are not listed.

(iii) Interest of Rs. 18,000 paid by State Government on security held by Mr. Kanha.

(iv) Interest of Rs. 15,000 paid by RBI on 7.75% Savings (Taxable) Bonds, 2018 held by Mr. Vishnu.

27.2 DEDUCTION OF TAX AT SOURCE FROM INTEREST OTHER THAN INTEREST ON SECURITIES

Section:- 194A Modified by Finance Act, 2018 w.e.f. 1st April, 2018

(A) Person liable to deduct tax at source:- Any person, not being an individual or a HUF, who is responsible for paying to a resident any income by way of interest other than income chargeable as interest on securities, is required to deduct tax at source.

However, an individual or a Hindu undivided family, whose total sales, gross receipts or turnover from the business or profession carried on by him exceed the monetary limits specified under section 44AB (a)/(b) during the financial year immediately preceding the financial year in which such interest is credited or paid, shall be liable to deduct income-tax under this section.

(B) Time of deduction:- Tax shall be deducted under this section, either at the time of credit to the account of the payee or at the time of payment thereof, whichever is earlier.

For this purpose, credit to “Interest payable account” or “Suspense account” or any other name shall be deemed to be a credit of such income to the account of the payee.

For this purpose, “payment” can be in cash or by issue of a cheque or draft or any other mode.

(C) Rate of TDS:- 10%

(D) By virtue of section 194A(3), tax is not deductible in the following cases:

(1) where the aggregate amount of interest credited or paid or likely to be credited or paid during the financial year **does not exceed**

- a. Rs.10,000 where the payer is a banking company;
- b. Rs.10,000 where the payer is a co-operative society engaged in business of banking;
- c. Rs. 10,000 where the payer is a post office;
- d. Rs.5,000 in any other case.
- e. **Provided also that in case of payee being a senior citizen, the limit of Rs. 10,000 at clause (a), clause (b) and clause (c) shall be substituted for Rs. 50,000 [Amendment by Finance Act, 2018 w.e.f. 01.04.2018]**

The aforesaid limit of Rs.10,000 shall be computed with reference to the income credited or paid by a branch of the banking company or the co – operative society, as the case may be.

The benefit of branch wise limit of Rs. 10,000 shall not be available w.e.f. 01-06-2015 where such banking company or the co-operative society, as the case may be has adopted core banking solutions.

(2) where interest is credited or paid to

- a. any banking company,
- b. any co – operative society engaged in business of banking,
- c. any financial corporation established by or under Central, State or Provincial Act,
- d. the Life Insurance Corporation of India,
- e. the Unit Trust of India,
- f. any company or a co – operative society carrying on the business of insurance, or
- g. such other institution, association or body which Central Government may notify.

- (3) where interest is credited or paid by the firm to its partner;
- (4) where interest is credited or paid by a co – operative society (Other than Co-operative Bank) to its members;
- (5) where interest is credited or paid by co-operative society to any other co – operative society;
- (6) where interest is credited or paid in respect of deposits under the schemes of Post Office. However, Senior Citizen Savings Scheme, 2004 is subject to tax deduction at source;
- (7) where interest is credited or paid in respect of deposits with a banking company or with a co – operative society engaged in carrying on the business of banking. However, interest paid on time deposits is subject to tax deduction at source;

The expression “time deposits” has been defined to mean deposits, including recurring deposits, repayable on the expiry of fixed period.

- (8) where interest is credited or paid in respect of deposits with a primary agricultural credit society or primary credit society or co – operative land mortgage bank or co – operative land development bank; and
 - (9) where interest is credited or paid by the Central Government under any provision of the Direct Taxes.
 - (10) Where the interest is paid on compensation awarded by the Motor Accidents Claims Tribunal if the amount or the aggregate amount of such income paid during financial year **does not exceed Rs. 50,000;**
 - (11) Income paid or payable by an infrastructure capital company or infrastructure capital fund or public sector company or scheduled bank in relation to zero coupon bonds issued by them.
- (E) The person responsible for paying interest may, at the time of deducting tax at source, increase or decrease the amount to be deducted for the purpose of adjusting any previous deficiency or excess deduction.

Practical 2

Mr. Ramesh, a resident senior citizen, opened recurring deposit account with State Bank of India. Manager, SBI wants to deduct tax at source under section 194A on interest component Rs. 42,000. Mr. Ramesh objected tax deduction on the ground that recurring deposit is not covered within the meaning of “Time deposit” for the purpose of section 194A. Discuss the validity of objection raised by Mr. Ramesh.

Is there any other objection Mr. Ramesh can raise?

27.3 DEDUCTION OF TAX AT SOURCE FROM INSURANCE COMMISSION

Section:- 194D

- (A) **Person liable to deduct tax at source:** - Any person responsible for paying to a resident any income by way of remuneration or reward, whether by way of commission or otherwise, for soliciting or procuring insurance business including business relating to the continuance, renewal or revival of policies of insurance, is required to deduct tax at source.
- (B) **Time of deduction:-** Tax shall be deducted under this section, either at the time of credit to the account of the payee or at the time of payment thereof, whichever is earlier.
- For this purpose, “payment” can be in cash or by issue of a cheque or draft or by any other mode.
- (C) **Threshold limit:-** No deduction shall be made under this section in a case where the amount of such income or, as the case may be, the aggregate of the amounts of such income credited or paid or likely to be credited or paid during the financial year to the account of payee, **does not exceed Rs. 15,000.**

(D) Rate of TDS:-

If payee is domestic company	10%
If payee is other person	5%

Practical 3

"Profit Commission" of Rs. 1 lac paid 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. Whether re-insurance company is required to deduct tax at source?

Solution

- In order to attract section 194D, the commission or any other payment covered under the section shall 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, no tax deduction under section 194D is required.

Reader's Note:**27.4 TAX TO BE DEDUCTED ON NON-EXEMPT PAYMENTS MADE UNDER LIFE INSURANCE POLICY****Section:- 194DA**

(A) Person liable to deduct tax at source: - Any person responsible for paying **to a resident** any sum under a life insurance policy, including the sum allocated by way of bonus on such policy, other than the amount not includible in the total income under section 10(10D), shall deduct income-tax thereon.

(B) Time of tax deduction:- Tax shall be deducted at **the time of payment** thereof.

(C) Threshold Limit:- No deduction under this section shall be made where the amount of such payment or, as the case may be, the aggregate amount of such payments to the payee during the financial year is **less than Rs.1,00,000**.

(D) Tax rates:- 1%

SECTION 10(10D)

Any amount received by an Individual under life insurance policy including any bonus allowed on such policy is exempt from tax under section 10 (10 D).

However, following amount received shall not be exempt from tax

- (1) Any sum received u/s 80DD(3)
- (2) Any sum received under keyman insurance policy
- (3) Any sum received under following insurance policy where insurance Premium *exceeds the maximum ceiling given below:-*

<i>In respect of policies issued</i>	<i>Where the insurance is on the life of a person with disability or severe disability as referred to in section 80U or a person suffering from disease or ailment as specified u/s 80DDB.</i>	<i>Where the insurance is on the life of any other person</i>
<i>Between 1.4.2003 and 31.3.2012</i>	<i>20% of sum assured*</i>	<i>20% of sum assured*</i>
<i>On or after 1.4.2012 but before 1.4.2013</i>	<i>10% of sum assured*</i>	<i>10% of sum assured*</i>
<i>On or after 1.4.2013</i>	<i>15% of sum assured*</i>	<i>10% of sum assured*</i>

**Sum assured means minimum amount assured under the policy without including any premium agreed to be returned and/or any benefit by way of bonus.*

(4) However, any sum received under point (3) above, on death of a person, is exempt.

Practical 4

From the following information, find out tax to be deducted by Life Insurance Company.

Sr.No.	Policy Holder	Date of issue of Policy	Sum Assured (Rs.)	Annual Premium (Rs.)	Maturity Date	Maturity Amount (Rs.)
(i)	Naresh	01.04.2016	5,00,000	1,25,000	31.03.2019	5,50,000
(i)	Ramesh	05.02.2012	3,00,000	40,000	04.02.2019	3,85,000
(ii)	Mahesh	08.03.2016	80,000	18,000	07.03.2019	87,000

Solution

- (i) Since the annual premium exceeds 10% of sum assured in respect of a policy taken on or after 1.4.2012, the maturity proceeds of Rs. 5,50,000 are not exempt under section 10(10D) in the hands of policy holder. Therefore, tax is required to be deducted @1% u/s 194DA on the maturity proceeds of Rs. 5,50,000.
- (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. 3,85,000 would be exempt under section 10(10D) in the hand of policy holder. Hence, no tax is required to be deducted at source under section 194DA on the maturity proceeds of Rs. 3,85,000.
- (iii) Even though the annual premium exceeds 10% of sum assured in respect of a policy taken on or after 1.4.2012, and consequently, the maturity proceeds of Rs. 87,000 would not be exempt under section 10(10D) in the hands of policy holder, the tax deduction under section 194DA is not required since the maturity proceeds are less than Rs. 1,00,000.

Reader's Note:**27.5 PAYMENT TO NON – RESIDENT SPORTSMAN OR SPORTS ASSOCIATION OR ENTERTAINER****Section:- 194E**

(A) Person liable to deduct tax at source:- Any person responsible for making following payment shall deduct tax at source.

Payee	Nature of income
(a) Non – resident foreign citizen sportsman (including an athlete)	Income is by way of- a. participation in India in any game (other than card game or gambling, etc); or b. advertisement; or c. contribution of articles relating to any game or sport in

	India in newspapers, magazines or journals
(b) Non – resident sports association or institution	Any amount guaranteed to be paid or payable in relation of any game (other than card game, etc.) or sport played in India.
(c) Non- resident foreign citizen entertainer	Income is from his performance in India.

(B) Time of deduction:- Tax is to be deducted at the time of credit of such income to the account of the payee or at the time of payment, whichever is earlier.

For this purpose, “payment” can be in cash or by issue of a cheque or draft or by any other mode.

(C) Tax rate:- 20% (Plus SC & EC)

27.6 DEDUCTION OF TAX AT SOURCE FROM INCOME BY WAY OF RENT

Section:- 194I

(A) Person liable to deduct tax at source:- Any person, not being an individual or a HUF, who is responsible for paying rent to a resident is required to deduct tax at source under the provisions of section 194 – I .

An individual or a Hindu undivided family, whose total sales, gross receipts or turnover from the business or profession carried on by him exceed the monetary limits specified under clause (a) or clause (b) of section 44AB during the financial year immediately preceding the financial year in which such rent is credited or paid, shall be liable to deduct income-tax under this section.

(B) Time of deduction:- Tax shall be deducted under this section, either at the time of credit to the account of the payee or at the time of payment thereof, whichever is earlier.

For this purpose, credit to “Suspense account” or any other name shall be deemed to be a credit of such income to the account of the payee.

For this purpose, “payment” can be in cash or by issue of a cheque or draft or by any other mode.

(C) Tax rates:-

Particulars	Rate of Tax
For the use of any machinery or plant or equipment	2%
For the use of any land or building (including factory building) or furniture or fittings	10%

(D) Threshold limit: No deduction shall be made under this section where the amount of such income or, as the case may be, the aggregate of the amounts of such income credited or paid or likely to be credited or paid during the financial year to the account of the payee, **does not exceed Rs. 1,80,000.**

(E) Definition of Rent:

“Rent” means any payment, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of (either separately or together) any,—

- (a) land; or
- (b) building (including factory building); or
- (c) land appurtenant to a building (including factory building); or
- (d) machinery; or

- (e) plant; or
- (f) equipment; or
- (g) furniture; or
- (h) fittings,

whether or not any or all of the above are owned by the payee.

(F) Other points: - No deduction shall be made under this section, where the income by way of rent is credited or paid to a business trust, being a real estate investment trust, in respect of any real estate asset, referred to in section 10(23FCA), owned directly by such business trust.

Practical 5

Gujarat Newspaper Society (GNS) has acquired a plot of land on 80 years lease on payment of lease premium. This payment being lump sum lease premium or one-time upfront lease charges, which are not adjustable against periodic rent. Discuss the obligation of GNS to deduct tax at source on such lease premium.

Solution

The CBDT vide Circular No.35/2016, DATED 13-10-2016 has made following observations

1. The Board has taken note of the fact that in the case of The Indian Newspaper Society (ITA Nos. 918 & 920/2015), the Hon'ble Delhi High Court has ruled that lease premium paid by the assessee for acquiring a plot of land on an 80 years lease was in the nature of capital expense not falling within the ambit of section 194-I of the Act. In this case, the court reasoned that since all the rights easements and appurtenances in respect of the said land were in effect transferred to the lessee for 80 years and since there was no provision in lease agreement for adjustment of premium amount paid against annual rent payable, the payment of lease premium was a capital expense not requiring deduction of tax at source under section 194-I of the Act.
2. Further, in the case Foxconn India Developer Limited (Tax Case Appeal No. 801/2013), the Hon'ble Chennai High Court held that the one-time non-refundable upfront charges paid by the assessee for the acquisition of leasehold rights over an immovable property for 99 years could not be taken to constitute rental income in the hands of the lessor, obliging the lessee to deduct tax at source under section 194-I of the Act and that in such a situation the lease assumes the character of "deemed sale". The Hon'ble Chennai High Court has also in the cases of Tril Infopark Limited (Tax Case Appeal No. 882/2015) ruled that TDS was not deductible on payments of lump sum lease premium by the company for acquiring a long-term lease of 99 years.

Conclusion

In view of the above, it is clarified that lump sum lease premium or one-time upfront lease charges, which are not adjustable against periodic rent, paid or payable for acquisition of long-term leasehold rights over land or any other property are not payments in the nature of rent within the meaning of section 194-I of the Act. Therefore, such payments are not liable for TDS under section 194-I of the Act.

Reader's Note:

27.7 TAX DEDUCTION AT SOURCE ON PURCHASE OF IMMOVABLE PROPERTY

Section:- 194 – IA

(A) Person liable to deduct tax at source: - Any person, being a transferee responsible for paying (other than the person referred to in section 194LA) to a resident transferor any sum by way of consideration for transfer of any immovable property (other than agricultural land), is liable to deduct tax at source under this section.

(B) Time of deduction: - Tax shall be deducted under this section, either at the time of credit to the account of the payee or at the time of payment thereof, whichever is earlier.

For this purpose, “payment” can be in cash or by issue of a cheque or draft or by any other mode.

(C) Threshold Limit: - No tax is deductible where the consideration paid or payable for the transfer of an immovable property is **less than Rs.50,00,000**.

(D) Tax rate: - 1% of consideration

(E) Other points: -

(a) Provisions of section 203A (pertaining to TAN) shall not apply to a person required to deduct tax under this section.

(b) As discussed above, the provisions of section 194-IA shall not apply if a person acquires agricultural land in India. For this purpose, the definition of section 2(14) shall be relevant.

Section 2(14) defines capital asset which excludes agricultural land in India.

Agricultural land means the land falling **outside** urban area.

Meaning of Urban area

(1) Urban area means any area which is situated within the jurisdiction of a municipality or cantonment board having a population of 10,000 or more.

(2) Urban area also includes an area which is situated outside the local limits of such municipality/cantonment board but within distance given below –

Population of municipality / cantonment board	Distance measured aerially
More than 10,000 but not exceeding 1 lakh	2 kilometers
More than 1 lakh but not exceeding 10 lakh	6 kilometers
More than 10 lakhs	8 kilometers

For the above purpose, “population” means the population according to the last preceding census of which the relevant figures have been published before the date of valuation.

(c) For deduction of tax at source under this section, location of immovable property is not relevant. Such property may or may not be situated in India. The main requirement to attract this section is that transferor shall be resident in India.

Practical 6

One fine day, Mr. X, a resident, acquired a house property at Mumbai from Mr. Y for a consideration of Rs. 90 lakhs (stamp duty value Rs. 98 lakhs). 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 lakhs (stamp duty value Rs. 54 lakhs) and rural agricultural land from Mr. D for a consideration of Rs. 60 lakhs.

Discuss the obligation of Mr. X to deduct tax at source and also find out the amount of TDS assuming that Mr. Y, Mr. C and Mr. D are residents.

Solution

Particulars	Rs.
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% u/s 194-IA on Rs. 90 lakhs, being the amount of consideration for transfer of property. It is important to bear in mind that the threshold limit and rate of tax deduction at source are prescribed with reference to the amount of consideration and not with reference to the stamp duty valuation.	90,000

Mr. X is not required to deduct tax at source u/s 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 u/s 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 u/s 194-IA.	Nil

Reader's Note:**27.8 PAYMENT OF RENT BY CERTAIN INDIVIDUALS / HUFs****Section:- 194 – IB**

- (A) Person liable to deduct tax at source:-** Any person, being an individual or a Hindu undivided family (other than those who are covered under section 194-I), responsible for paying to a resident any income by way of rent, shall deduct an amount equal to five per cent of such income as income-tax thereon.
- The provisions of this section shall not be applicable to the individual or Hindu undivided family who are liable to deduct tax at source under section 194-I.
- (B) Time of tax deduction –** Tax is deductible at the time of credit of rent, for the last month of the previous year or the last month of tenancy, if the property is vacated during the year, as the case may be, 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.
- (C) Threshold limit –** Tax is deductible if rent is exceeding fifty thousand rupees for a month or part of a month during the previous year.
- (D) Rate of TDS-** Tax is deductible at the rate of 5 per cent of Rent
- (E) Ceiling on TDS :-** In a case where the tax is required to be deducted as per the provisions of section 206AA (i.e. if payee does not provide PAN), such deduction shall not exceed the amount of rent payable for the last month of the previous year or the last month of the tenancy, as the case may be.
- (F) Meaning of Rent:-** For the purposes of this section, "rent" means any payment, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of any land or building or both.

Practical 7

Mr. Madhukant is an employee of M/s. PQR Ltd. He had taken property on rent from Mr. Suresh, resident, for his residential purpose for the monthly rent of Rs. 70,000 w.e.f. **1st February, 2019**. He claims that he is not required to deduct tax at source since (i) he is not an assessee covered by tax audit under section 44AB(a)/(b) (ii) rent for the financial year **2017-18** does not exceed Rs. 1,80,000 (limit prescribed under section 194-I). Advise him with regard to his TDS obligation.

Solution

- The contention of Mr. Madhukant is true with regard to provisions of Section 194-I. However, with effect from 1st June, 2017, section 194-IB has been inserted by Finance Act, 2017 requiring individual or a Hindu undivided family (other than those referred to in the second proviso to section 194-I), to deduct tax at source at the rate of five percent if he or it is responsible for paying rent to a resident any income by way of rent exceeding fifty thousand rupees for a month or part of a month during the previous year.
- Therefore, Mr. Madhukant is required to deduct tax at source under section 194IB in the month of **March, 2019** on Rs.1,40,000 at the rate of 5%.

Reader's Note:

Practical 8

Mr. Ramakant, senior Chief Financial officer of M/s. DANGAR Ltd. He had taken property on rent from Mr. Ganesh, resident, for his residential purpose for the monthly rent of Rs. 1,50,000 w.e.f. **1st July, 2019**. Advise Mr. Ramakant for deduction of tax under section 194-IB with regard to the time of deduction and the amount, assuming that Mr. Ganesh does not provide PAN.

Solution

- With regard to the time of deduction, Mr. Ramakant shall deduct tax at source annually in the last month of the financial year (**i.e. March, 2019**) on total rent of Rs. 13,50,000 (i.e. 1,50,000 X 9 months). However, rate of TDS shall be 20% since Mr. Ganesh has not provided PAN.
- With regard to amount of TDS, it shall be ideally Rs. 2,70,000 (20% of Rs.13,50,000). But the rent of last month is only Rs. 1,50,000. Therefore, as per the ceiling suggested under section 194 IB, Mr. Ramakant shall not exceed tax more than the rent of last month i.e. Rs. 1,50,000.

Reader's Note:**Practical 9**

Mr. Jaykant runs proprietorship in the name and style M/s. MASIKOTAR TRADING. He pays shop rent to Mr. Shrenik, resident Rs. 20,000 p.m. with effect from **1st April 2018**. Advise him with regard to TDS obligation under following alternatives:

- (a) Total turnover of M/s. MASIKOTAR TRADING for the previous year **2017-18** was Rs. 2.5 Cr.
 (b) Total turnover of M/s. MASIKOTAR TRADING for the previous year **2017-18** was Rs. 95 Lakhs.

Solution**Alternative (a):**

- Since turnover for the previous year **2017-18** exceeded monetary limit for tax audit under section 44AB(a), Mr. Jaykant is subject to Section 194-I. Under this section, he is not required to deduct tax at source on rent, if rent paid during the financial year does not exceed Rs. 1,80,000.
- In the present case, annual rent is Rs. 2,40,000, (it exceeded limit of Rs. 1,80,000). Therefore, Mr. Jaykant shall deduct tax at source at 10% under section 194-I, at the time of credit to Mr. Shrenik or at the time of payment whichever is earlier.

Alternative (b):

- Since turnover for the previous year **2017-18** has not exceeded monetary limit for tax audit under section 44AB(a), Mr. Jaykant is not governed by the provisions of Section 194-I but his case falls under the provisions of section 194-IB.
- However, provision of section 194-IB is made applicable only when rent is exceeding fifty thousand rupees for a month or part of a month during the previous year.
- In the present case, monthly rent is Rs. 20,000 (not exceeding Rs. 50,000), Mr. Jaykant is not required to deduct tax at source under section 194-IB also.

Reader's Note:**27.9****TAX DEDUCTION AT SOURCE ON PURCHASE OF IMMOVABLE PROPERTY****Section:- 194 – IC**

(A) Person liable to deduct tax at source:- Any person responsible for paying to a resident any sum by way of consideration under the specified agreement u/s 45(5A), shall deduct tax at source.

(B) Time of tax deduction – Tax shall be deducted under this section, either at the time of credit to the account of the payee or at the time or payment thereof, whichever is earlier.

For this purpose, “payment” can be in cash or by issue of a cheque or draft of by any other mode.

(C) **Threshold limit** – Nil

(D) **Rate of TDS** - 10 per cent

(E) **No Tax is deductible:-** Tax deduction at source shall not be made in respect of that part of consideration which is in kind under the specified agreement.

(F) **Meaning of “Specified agreement”:-** "Specified agreement" means a registered agreement in which a person owning land or building or both, agrees to allow another person to develop a real estate project on such land or building or both, in consideration of a share, being land or building or both in such project, whether with or without payment of part of the consideration in cash.

Practical 10

In terms of agreement between A (the Owner of Land) and B (Developer and Builder) the Developer, B agrees to allot 5 apartments to the owner in part consideration for providing his land and also agreed to pay a sum of Rs.25,00,000. In terms of the agreement, Mr. B issued a cheque for Rs.15,00,000 towards part of consideration on **30.03.2019**. Whether B is responsible to deduct tax at source?

Solution

The agreement entered into between A (the owner of land) and B (developer and builder) is a “specified agreement” in terms of section 45(5A) of the Act. Therefore, B is required to deduct tax at source under section 194-IC of the Act.

In view of the provisions of section 194-IC of the Act, tax deduction at source shall not be made in respect of that part of consideration which is in kind under the specified agreement.

Therefore, B is required to deduct tax at source @ 10% on Rs. 15,00,000 assuming that no amount has been credited to A’s account in his books of accounts.

Reader’s Note:

27.10 TAX DEDUCTION AT SOURCE ON FEES FOR PROFESSIONAL OR TECHNICAL SERVICES

Section:- 194 J

(A) **Person liable to deduct tax at source:** - Any person, not being an individual or a HUF, who is responsible for paying to a resident any sum by way of -

- (a) fees for professional services, or
- (b) fees for technical services or
- (c) any remuneration or fees or commission by whatever name called, other than those on which tax is deductible under section 192, to a director of a company or
- (d) royalty or
- (e) any sum referred to in section 28 (va) ;

shall deduct tax at source under this section.

An individual or a Hindu undivided family, whose total sales, gross receipts or turnover from the business or profession carried on by him exceed the monetary limits specified under clause (a) or clause (b) of section 44AB during the financial year immediately preceding the financial year in which abovementioned sum is credited or paid, shall be liable to deduct income-tax under this section.

However, no tax deduction under this section is required on sum by way of fees for professional services in case such sum is exclusively for personal purposes of such individual or any member of Hindu Undivided Family.

(B) Time of deduction: - Tax shall be deducted under this section, either at the time of credit to the account of the payee or at the time of payment thereof, whichever is earlier.

For this purpose, credit to “Suspense account” or any other name shall be deemed to be a credit of such income to the account of the payee.

For this purpose, “payment” can be in cash or by issue of a cheque or draft or by any other mode.

(C) Threshold limit: - No tax is deductible if the amount credited or paid or likely to be credited or paid during the financial year to the account of the payee does not exceed-

Nature of Payment	Separate Threshold Limit (in Rs.)
Professional services	30,000
Fees for Technical Services	30,000
Royalty	30,000
Sum referred to in a section 28(va)	30,000

(D) Tax rate:- 10%. (2% in case of payee engaged only in the business of operations of call centre- Amendment with effect from 1st June, 2017)

Practical 11

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 **6.10.2018**. The total sum of Rs. 55,000 was paid by cheque to HG on **18.12.2018**. Examine the obligation of BCD Ltd. in respect of tax deduction at source.

Solution

As discussed above, the threshold 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. That means 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 exceeded 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.

Reader's Note:

Practical 12

KD, an independent director of DAF Pvt. Ltd. was paid an amount of Rs. 22,500 sitting fees for attending the various meetings held during the financial year. Examine the obligation of DAF Pvt Ltd. in respect of tax deduction at source.

Solution

- 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 u/s 192. Further, no threshold limit has been prescribed for tax deduction in such cases.
- Hence, tax is required to be deducted at source under section 194J @10% by DAF Pvt. Ltd. on the sitting fees of Rs. 22,500 paid to KD, an independent director. The tax deductible under section 194J would be Rs. 2,250 being 10% of Rs. 22,500.

Reader's Note:

(E) Meaning of professional services:- It means services rendered by a person in the course of carrying on-

(a) legal,

- (b) medical,
- (c) engineering,
- (d) architectural profession,
- (e) the profession of accountancy,
- (f) technical consultancy,
- (g) interior decoration,
- (h) advertising (i.e., models, artists, photographers providing services to an advertising agency),
- (i) such other profession as is notified by the Board for the purpose of section 44AA or of this section.

Notification No. 88/2008 / F.No. 275/43/2008-IT(B), DATED 21-8-08

SECTION 194J OF THE INCOME-TAX ACT, 1961 DEDUCTION AT SOURCE OF TAX NOTIFIED PROFESSIONAL SERVICES

In exercise of the powers conferred by clause (a) of the Explanation to section 194J of the Income Tax Act, 1961, Central Board of Direct Taxes hereby notifies the services rendered by following persons in relation to the sports activities as Professional Services for the purpose of the said section, namely:

Sports Persons,
 Umpires and Referees,
 Coaches and Trainers,
 Team Physicians and Physiotherapists,
 Event Managers,
 Commentators,
 Anchors and
 Sports Columnists.

Practical 13

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

- 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 has 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.

Reader's Note:

Practical 14

Explain 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 Mr. Pushpendrasingh for organizing a debate competition on the subject "Preservation of Rural Heritage of Rajasthan".
- (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.

Solution

- (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

Mr. Pushpendrasingh for organization of a debate competition. Hence, the provisions of section 194J are not attracted.

However, TDS provisions under section 194C would be attracted and consequently, tax has to be deducted @ 1% under section 194C.

The tax deductible under section 194C would be Rs.5,000, being 1% of Rs.5 lacs.

- (ii) 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.

Reader's Note:

(F) Meaning of fees for technical services: It shall have same meaning as given in explanation 2 to sec. 9(1)(vii).

Practical 15

P Ltd. is engaged in manufacturing of a product. It paid a lump-sum deposit and obtained 50 mobile phone services so that the employees of the assessee can be contacted immediately. The company paid Rs. 45,000 every month towards the service and call charges to the mobile phone franchise. On these facts :

- (i) Whether P Ltd has to deduct tax at source on the payment?
- (ii) If so, under which provisions of the Act?

Solution

In this case, the assessee pays the service and call charges every month to a mobile phone franchise. Explanation 2 to section 9(1)(vii) provides that “fees for technical services “ means any consideration (including any lump sum consideration) for the rendering of any managerial ,technical, or consultancy services (including the provision of services of technical and other personnel).

Therefore, mere collection of fee by mobile phone franchise from the customers for use of mobile phone services will not amount to receipt of fees towards technical services. The payment made is for the use of airtime. Installation of technical equipment to ensure connectivity to subscriber cannot make it technical services. Therefore, P Ltd. does not have to deduct tax at source under section 194J on the payments made to the mobile phone franchisee towards the service and call charges. This view was upheld by Madras High Court in **Skycell Communications Ltd. V Dy. CIT (2001) 251 ITR 53.**

Reader's Note:

(G) Meaning of royalty: It shall have same meaning as given in explanation 2 to section 9(1)(vi).

Practical 16

Treat- Treat Limited purchased animation software from Gajanan Agency for Rs. 12,00,000. It seeks your advice about applicability of TDS provisions / relaxation if any.

Solution

Considering the **Notification No. 21/2012 dated 13.06.2012**, Treat-Treat limited is not required to deduct tax at source from the payment on account of software subject to:

- (1) Such software is acquired in a subsequent transfer without any modification by Gajanan Agency.
- (2) Tax has been deducted either under section 194 J or under section 195 on payment for such software in previous transfer (either by Gajanan Agency or previous transferor).
- (3) It shall obtain declaration from Gajanan Agency that tax has been so deducted.
- (4) It shall also obtain the PAN of Gajanan Agency.

Reader's Note:

27.11 | BRAIN STORMING PRACTICALS**Section:- Various Sections****Practical 17**

Discuss 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 previous year.

- (i) M/s. Jiva & Co., a partnership firm, pays a sum of Rs.43,000 as interest on loan borrowed from an State Bank of India.
- (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

Solution

- (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. 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.
- (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.
On the other hand, 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) U/s 195, if no sum is chargeable to tax in India, then there is no liability on payer to deduct tax at source. As per sect. 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 subject to 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.

Reader's Note:**Practical 18**

IPL Organisers Ltd would like to make payment to following persons in relation to IPL cricket matches played in India. Advise IPL Organisers Ltd. regarding appropriate section under which tax deduction is to be made?

- (i) Resident Cricketer
- (ii) Non-Resident Cricketer
- (iii) Resident Umpire
- (iv) Non-Resident Umpire
- (v) Non-Resident Cheer Girls
- (vi) Resident Physiotherapists

- (vii) Non-resident Coach
- (viii) Resident Event Manager, Mr. Mohan
- (ix) Resident Event Manager, Gilli & Co., Partnership Firm

Solution

Reader's Note:

Practical 19

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 GST. 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, has, vide Circular No. 23/2017 dated 19.07.2017 clarified that wherever in terms of the agreement or contract between the payer and the payee, the component of 'GST on services' comprised in the amount payable to a resident is indicated separately, tax shall be deducted at source on the amount paid or payable without including such 'GST on services' component.

GST shall include Integrated Goods and Services Tax, Central Goods and Services Tax, State Goods and Services Tax and Union Territory Goods and Services Tax.

Considering the abovementioned circular, Mahanadi Limited is required to deduct tax at source under section 194-I from gross amount of rent without including applicable GST.

Reader's Note:

Practical 20

Mention the section no. under which TDS to be made and the rate of TDS.

- (i) Interest paid to FII in respect of rupee denominated bond of an Indian company
- (ii) Interest paid to FII in respect of debenture of an Indian company
- (iii) Payment to FII resulting into Long term capital gain on transfer of security
- (iv) Payment to FII resulting into Short term capital gain on transfer of security
- (v) Interest paid to non-resident by infrastructure debt fund referred to in section 10(47) (Non-resident does not have PAN)
- (vi) Interest paid to non-resident on long term infrastructure bond issued by an Indian company (Non-resident does not have PAN)

Solution**Reader's Note:****27.12 CONSEQUENCES OF FAILURE TO DEDUCTE OR PAY****Section:- 201****Practical 21**

Examine critically in the context of provisions contained in Income-tax Act, 1961 as to the correctness of the submission of the company.

M/s Soft Drinks Limited entered into an agreement for the warehousing of its products with XYZ Warehousing and deducted tax at source as per provisions of section 194C out of warehousing charges paid during the year ended on **31.03.2018**. The Assessing Officer, while completing the assessment for **A.Y. 2018-19** of Soft Drinks Limited in **March 2019**, treated the warehousing charges as rent as defined in section 194-I and asked the company to make payment of difference amount of TDS with interest. It was submitted by the company that the recipient had already paid tax on the entire amount of warehousing charges and therefore, now the difference amount of TDS cannot be recovered. However, it will make the payment of due interest on the difference amount of TDS.

Solution

- Section 201 provides that the payer (including the principal officer of the company) who fails to deduct the whole or any part of the tax on the amount credited or payment made to a resident payee shall not be deemed to be an assessee-in-default in respect of such tax if such resident payee–
 - (1) has furnished his return of income under section 139;
 - (2) has taken into account such sum for computing income in such return of income; and
 - (3) 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.

- However, 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) as mentioned above, 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.
- Therefore, M/s Soft Drinks Limited shall not be required to pay the difference tax in case the above-mentioned conditions are fulfilled. However, the assessee shall be liable to make payment of interest from the date on which such tax was deductible to the date of furnishing of return of income by XYZ Warehousing.
- Therefore, the submission of the assessee company, in this case, is correct

Reader's Note:**Practical 22**

A sum of Rs.60,000 was paid to Mr. Dastur, an advocate, on **1st July, 2018** towards fees for his professional services without deducting tax at source. Later on, a further sum of Rs.70,000 was due to him on **28th February, 2019** from which tax of Rs. 13,000 was deducted at source. The tax so deducted was deposited on **25th June, 2019**. Compute interest payable by the deductor under section 201(1A).

Solution

- In this case, tax is deductible @10% under section 194J in respect of fees for professional services. Since there has been a delay in deduction and deposit of tax, interest under section 201(1A) is attracted.
- As per the provisions of section 201(1A), if a person who is liable to deduct tax at source fails to deduct tax at source or after deducting such tax, fails to pay the tax as required by the Act, then he is liable to pay interest as follows -
 - 1% for every month or part of month on the amount of such tax from the date on which such tax was deductible to the date on which such tax is actually deducted.
 - 1½% for every month or part of month on the amount of such tax from the date on which such tax was deducted to the date on which tax is actually paid.
- Therefore, in the given case, interest under section 201(1A) would be computed as follows –

Particulars	Rs.
1% on tax deductible but not deducted i.e., 1% on Rs.6,000 for 8 months	480
1½% on tax deducted but not deposited i.e. 1½% on Rs. 13,000 for 4 months	780
Total interest payable under section 201(1A)	1,260

Reader's Note:**Practical 23**

A foreign company seconded some employees to the assessee, an Indian collaborator. These employees worked with the Indian collaborator throughout the financial year. 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?

Solution

- Section 9(1)(ii) provides that any income which falls under the head “salaries” is deemed to 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 financial year. 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, 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 u/s 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.

Reader’s Note:**Practical 24**

Syed & Co., a dealer in motor cycles conducted motor cycle race on the occasion of its' 25th year anniversary. The prize was given to first 3 winners by way of a luxury motor cycle which was worth Rs.2 lakhs each. The assessee did not deduct tax at source on the prize given to the winners. The Assessing Officer treated the assessee as an assessee in default and passed order under sections 201(1). The assessee seeks your advice on the validity of the order and other legal consequences. Advise.

Solution**Provision applicable:**

Section 194 B: 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 ` 10,000 shall deduct tax at source @ 30%.

However, where the 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. **(Proviso to Section 194B)**

Section 201(1): Where any person, who is required to deduct any sum in accordance with the provisions of this Act, does not deduct, or does not pay, or after so deducting fails to pay such tax, then, such person, without prejudice to any other consequence which he may incur, be deemed to be an assessee in default.

Analysis: Hon'ble Karnataka High Court in CIT v. Hindustan Lever Ltd. (2014) 361 ITR 1 had made following observations:

"We have already perused Section 194-B, in particular, the proviso thereto, it is clear that there could be winnings wholly in kind and in which case, the duty casts on the person responsible for paying is to ensure that tax has been paid in respect of the winnings before releasing it to the winner. The proviso makes it further clear that no duty of deduction of tax in respect of the winnings is cast on the person who is responsible for paying, where the winnings is wholly in kind. Undoubtedly, in that eventuality such person should ensure that the tax has been paid in respect of the winnings before releasing it to the winner.

The combined reading of Section 194B and Section 201 would show that if any such person fails to "deduct" the whole or any part of the tax or after deducting, fails to pay the tax or required by or under this Act, without prejudice to any other consequences, which he may incur, be deemed to be an assessee in default in respect of the tax. In other words, the provisions contained in these sections do not cast any duty/responsibility to deduct the tax at source where the winnings is wholly in kind. If the winnings is 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 the provisions of the Act, is to ensure that tax is paid by the winner of the prize before the prize or winnings is released."

Conclusion: Applying the rationale of the Karnataka High Court to the facts of the present case, order passed under section 201(1) treating the dealer as an assessee-in-default is not tenable in law.

Other legal consequences:

Section 271C deals with "Penalty for failure to deduct tax at source." which reads as under:

271C. (1)

If any person fails to—

- (a) deduct the whole or any part of the tax as required by or under the provisions of Chapter XVII-B; or
- (b) pay the whole or any part of the tax as required by or under—
 - (i) sub-section (2) of section 115-O; or
 - (ii) the **proviso to section 194B**,

then, such person shall be liable to pay, by way of penalty, a sum equal to the amount of tax which such person failed to deduct or pay as aforesaid.

271C (2) Any penalty imposable under sub-section (1) shall be imposed by the Joint Commissioner.

Section 276B deals with "Failure to pay tax to the credit of Central Government under Chapter XII-D or XVII-B." which reads as under:

If a person fails to pay to the credit of the Central Government,—

- (a) the tax deducted at source by him as required by or under the provisions of Chapter XVII-B; or
- (b) the tax payable by him, as required by or under—
 - (i) sub-section (2) of section 115-O; or
 - (ii) the **proviso to section 194B**,

he 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.

On plain reading of the section 271C and 276B, the dealer would be liable for penalty equal to the sum of tax

deductible and prosecution by way of imprisonment and fine for failing to ensure that tax is paid by the winner of the prize before the winnings are released in his favour.

Reader's Note:

Practical 25

Raghav Infrastructure, a partnership firm, has been held to be an assessee in default under section 201(1) of the Act for the non-deduction of TDS of Rs. 20,00,000 and interest thereon under section 201(1A)(i). The argument was made by the Raghav Infrastructure that no-deduction is due to the fact that necessary documents for deduction of tax at source were seized by the Income Tax Department and the copies thereof was not made available in time. Raghav Infrastructure is ready to pay demand of Rs. 20,00,000, being principal amount. However, it seeks your advice for any possibility of waiver or reduction of interest levied under section 201(1A)(i).

Solution

CBDT vide Circular No. 11/2017, dated 24.03.2017 issued guidelines for waiver of interest under section 201(1A) (i) which reads as under:

In exercise of the powers conferred under section 119(2)(a), the CBDT has directed that the Chief Commissioner of Income-tax and Director General of Income-tax may reduce or waive interest charged under section 201(1A) (i) in the classes of cases specified below for the period and to the extent the Chief Commissioner of Income-tax/Director General of Income-tax may deem fit. However, no reduction or waiver of such interest shall be ordered unless the principal demand under sections 200A, 201(1) or 234E, as the case may be, stands fully paid or satisfactory arrangements for payment of the principal demand under these sections have been made. The Chief Commissioner of Income-tax or Director General of Income-tax may also impose any other condition as deemed fit for the said reduction or waiver of interest.

The class of cases in which the reduction or waiver of interest under section 201(1A)(i) can be considered, are as follows:

- (i) Where during the course of proceedings for search and seizure under section 132, or otherwise, the books of account and other documents necessary for making deduction under Chapter XVIIIB of the Act were seized and the assessee was not able to, within the time specified, deduct tax at source from any sum credited to any account (whether called "suspense account" or by any other name) in his books of account
- (ii) Where any sum paid or payable was not liable for deduction of tax at source in the case of a deductor on the basis of any order passed by the jurisdictional High Court, and as a result, he did not deduct tax at source in relation to such sum, and subsequently, in consequence of any retrospective amendment of law or a decision of the Supreme Court of India or a decision of a Larger Bench of the jurisdictional High Court (which was not challenged before the Supreme Court and has become final) in any proceedings, as the case may be, tax was held to be deductible or the tax deducted by the deductor during such financial year was found to be less than the tax deductible on such sums paid or payable.
- (iii) Where the default under section 201 relates to non-deduction or a lower deduction of tax under section 195 in respect of a payment made to a non-resident (including a foreign company) being a resident of a country or specified territory outside India with whom India has entered into an agreement referred to in section 90 or 90A of the Act, and where —
 - (a) a dispute regarding the tax payable in India in respect of the said payment had been referred to the Competent Authority in India mentioned in Rule 44H of the Income-tax Rules, 1962 under the said agreement under section 90 or 90A of the Act;
 - (b) such reference had been received by the Competent Authority in India within a period of two years of the date on which the notice of demand determining the tax payable was received by the person in

default under section 201;

- (c) the dispute has been settled by way of a resolution arrived at under the Mutual Agreement Procedure (MAP) provided in the said agreement; and
- (d) the person in default under section 201 has given his acceptance to the resolution and has withdrawn his appeal(s) pending on the issue, within the meaning of Rule 44H (4) of the Income-tax Rules, within a period of one month of the date on which the resolution is communicated to him

Even if the interest under section 201(1A) (i) has already been paid by the deductor, the same can be considered for waiver, subject to the conditions above and a refund may be given to the deductor, if waiver is ordered.

The Chief Commissioner of Income-tax or Director General of Income-tax examining an application for waiver of interest under this order shall pass a speaking order after providing adequate opportunity of being heard to the applicant.

Reader's Note:

28 - ADVANCE TAX**28.1 | INSTALMENTS OF ADVANCE TAX AND DUE DATES****Section:- 211**

Due date of instalment	Amount payable in case of all assessee (except an eligible assessee referred to in section 44AD or 44ADA of the Act)	Amount payable in case of an eligible assessee in respect of an eligible business referred to in section 44AD or 44ADA of the Act
On or before June 15 of the previous year	Upto 15 percent of advance tax payable	NA
On or before September 15 of the previous year	Upto 45 percent of advance tax payable	NA
On or before December 15 of the previous year	Upto 75 percent of advance tax payable	NA
On or before March 15 of the previous year	Upto 100 percent of advance tax payable	Upto 100 percent of advance tax payable

Any payment of advance tax made on or before 31st day of March shall also be treated as advance tax paid during the financial year.

29 - INTEREST U/S 234A, 234B, 234C & 234D**29.1 INTEREST FOR DEFAULTS IN PAYMENT OF ADVANCE TAX.****Section:- 234B****(1) Computation of interest at time of application made to Settlement Commission****(a) Period for which interest is payable**

It shall commence from the 1st day of assessment year and it shall end on the date of making an application to the settlement commission.

(b) Amount on which interest is payable

Additional Tax calculated as per the provisions of Chapter “Settlement Commission “.

(2) Computation of interest at time of final order passed by Settlement Commission**(a) Period for which interest is payable**

It shall commence from the 1st day of assessment year and it shall end on the date of order of settlement commission.

(b) Amount on which interest is payable

Particulars	Rs.
Tax on total income determined by the Settlement Commission	xxxx
Less: Tax on total income disclosed in the application	(xxx)
Amount on which interest is payable	<u>xxxx</u>

Practical 1

X Ltd. filed its return for the **A.Y. 2016-17** declaring income of Rs. 10,00,000. On **10-10-2018**, the assessee was in receipt of notice under section 148 for the **A.Y. 2016-17**, whereby X Ltd. was required to file return on or before **15-11-2018**. X Ltd. filed an application to settlement commission on **31-10-2018** declaring additional income of Rs. 60,00,000. Whether the application filed by X Ltd. to settlement commission is maintainable? Assume tax rate 30% for the **A.Y. 2016-17** and ignore education cess and surcharge for sake of simplicity.

Also find out interest under section 234B which shall be payable at the time of application.

Solution

In order to file an application before settlement commission following conditions must be satisfied:-

There should be a case:- It means proceeding of assessment or reassessment is pending before the assessing officer on date of application and

The additional tax exceeds Rs. 10 lakh (Rs. 50 lakh in search case)

Since proceeding under section 147 is pending before A.O., the condition at point (a) above is satisfied.

For condition (b), the Computation of additional tax is given as under:

Additional Tax = Tax on {Income returned + Income disclosed in Application} less Tax on income returned
 = Tax on {Rs. 10,00,000 + Rs. 60,00,000} less Tax on Rs. 10,00,000
 = Tax on Rs. 70,00,000 less tax on Rs. 10,00,000

= Rs. 21,00,000 less Rs. 3,00,000

= Rs. 18,00,0000

Since condition (b) is also satisfied, the application made by X Ltd before settlement commission is primarily maintainable.

Calculation of Interest Payable under section 234B at the time of application

(a) Period of Interest: **31 months** [i.e., from 01.04.2016 to 31.10.2018]

(b) Amount on which Interest is payable

Particulars	Rs.
Additional tax payable to Settlement commission	18,00,000
Amount on which Interest is payable	18,00,000

(c) Interest under section 234B [Rs.18,00,000 x 31 months x 1%]= Rs. 5,58,000

Readers Note:

Practical 2

Continuing above problem, the Settlement Commission passed the order on **17-08-2019** and made an addition of Rs. 5,00,000 over and above the income disclosed in application thereby determined total income at Rs. 75,00,000. Find out further interest payable under section 234B by X Ltd.

Solution

Calculation of Interest Payable under section 234B at the time of final order passed by Settlement Commission

(a) Period of Interest: **41 months** [i.e., from 01.04.2016 to 31.08.2019]

(b) Amount on which Interest is payable

Particulars	Rs.
Tax on total income determined by Settlement commission	22,50,000
Less: Tax on total income disclosed in the application	(21,00,000)
Amount on which Interest is payable	1,50,000

(c) Interest under section 234B [Rs.1,50,000 x 41 months x 1%]= Rs. 61,500.

Readers Note:

29.2 INTEREST FOR DEFERMENT OF ADVANCE TAX.

Section:- 234C

(1) Period for which and amount on which interest is payable

(A) Eligible assessee under section 44AD or 44ADA of the Act

Dates of Installment	Advance Tax Paid Till Date	Advance Tax Payable	Amount on which interest is payable [(3)-(2)]	Period for which interest is payable
(1)	(2)	(3)	(4)	(5)
15.03.19		100%		1 month

(B) Other assessee

<i>Dates of Installment</i>	<i>Advance Tax Paid Till Date</i>	<i>% of "tax due on returned income"</i>	<i>Amount on which interest is payable [(3)-(2)]</i>	<i>Period for which interest is payable</i>
(1)	(2)	(3)	(4)	(5)
15.06.18		15%		3 months
15.09.18		45%		3 months
15.12.18		75%		3 months
15.03.19		100%		1 month

However, no interest under section 234 C shall be levied for the first and second instalment, if advance tax paid by the assessee is not less than 12% or 36% of tax due on returned income.

(2) Points to remember**(a) Meaning of "Tax due on returned income"**

Particulars	Rs.
Tax on returned income	xxx
Less: TDS or TCS/ Relief u/s 90, 90A, 91/MAT credit u/s 115JAA/ AMT credit u/s 115JD	(xxx)
Tax due on returned income	xxxx

(b) Calculation of interest under section 234C is always with reference to "tax due on returned Income". Therefore interest under section 234C will not undergo change even if assessing officer may complete the assessment at higher figure under section 143(1) / 143(3) / 144 / 147 / 153A, as the case may be.

(3) Short payment of advance tax in case of capital gains/lottery income etc.

No interest will be levied in respect of any shortfall in the payment of advance tax due on the returned income where such shortfall is on account of under-estimate or failure to estimate-

- (a)** the amount of capital gains; or
- (b)** income of the nature referred to in section 2(24)(ix) (i.e., winning from lottery, crossword puzzle income, races including horse race etc.); or
- (c)** income under the head "PGBP" in cases where the income accrues or arises under that head for the first time
- (d)** income of the nature referred to in section 115BBDA (i.e. dividends received from domestic companies in excess of Rs. 10 lakhs during the year),

and the assessee has paid the whole of the amount of tax payable in respect of such income, as part of the remaining instalments of advance tax which are due or if no such instalments are due, then such tax is paid by the 31st day of March of the financial year.

Practical 3

Zandu & Co, a partnership firm submits the following information for the previous year **2018-19**.

Income under the head "PGBP"	4,95,190
LTCG on sale of land dated 1st November, 2018	98,560

You are required to compute the minimum amount of advance tax payable by Zandu & Co. for each of the installments in such a way that it will not attract interest liability under section 234C.

Solution

Particulars	Minimum amount of advance tax (Rs.)
1st Instalment of advance tax payable {15.06.2018} [upto 12%] Tax on PGBP Income Rs.4,95,190 @31.20% =Rs.1,54,500 <u>x 12%</u>	18,540
2nd Instalment of advance tax payable { 15.09.2018} [upto 36%] Tax on PGBP Income Rs.4,95,190 @31.20% =Rs.1,54,500 <u>x 36%</u>	37,080 [55,620-18,540]
3rd Instalment of advance tax payable {15.12.2018} [upto 75%] Tax on PGBP Income Rs.4,95,190 @31.20% =Rs.1,54,500 Add: Tax on LTCG Rs. 98,560 @ 20.80% =Rs. 20,500 Total Tax =Rs.1,75,000 <u>x 75%</u>	75,630 [1,31,250-18,540-37,080]
4th Instalment of advance tax payable {15.03.2019} [100%] Tax on PGBP Income Rs.4,95,190 @31.20% =Rs.1,54,500 Add: Tax on LTCG Rs. 98,560 @ 20.80% =Rs. 20,500 Total Tax =Rs.1,75,00 <u>x 100%</u>	43,750 [1,75,000-18,540-37,080-75,630]

Readers Note:**29.3 INTEREST ON EXCESS REFUND****Section:- 234D****(1) No refund is due on regular assessment**

Rate of interest	½ per cent per month or part of a month.
Period for which interest is payable	From the date of grant of refund under section 143 (1) to date of regular assessment.
Amount on which interest is payable	Whole of the amount refunded.

(2) Refund is granted under section 143(1) but refund so granted exceeds the amount refundable on regular assessment.

Rate of interest	½ per cent per month or part of a month.
Period for which interest is payable	From the date of grant of refund under section 143 (1) to date of regular assessment.
Amount on which interest is payable	Amount refundable on regular assessment Less amount refunded under section 143(1).

(3) Reduction of interest payable under section 234D as a result of order under section 154, 155, 250 etc.

Where, as a result of an order under section 154 or 155 or 250 or 254 or 260 or 262 or 263 or 264 or an order of the Settlement Commission under section 245D(4) the amount of refund granted under section 143(1) is held to be correctly allowed, either in whole or in part, as the case may be, then the interest chargeable in above para, shall be reduced accordingly.

Practical 4

Mr. X filed return of income for assessment year **2018-19** claiming a refund of Rs.45,000. The said refund was granted and paid to the assessee on **March 1, 2019** after processing the return under section 143(1). Later on, the case was taken up for regular assessment by issue of notice under section 143(2) and the said assessment was completed on **August 17, 2019** resulting in demand of Rs.2,500. Is the assessee liable to interest on the amount of refund already granted to him and if so, what is the amount of such interest?

Solution

The assessee is liable to interest on the amount of refund already granted to him under section 234D of the Act. The computation of interest under section 234D is as under:

Period of Interest: 6 Months [i.e., 01.03.2019 to 31.08.2019]

Interest under section 234D is Rs.1,350 (i.e., 45,000 x $\frac{1}{2}$ % x 6).

Readers Note:

Practical 5

Suppose in the above problem A.O determined amount refundable Rs.21,000 instead of demand Rs.2,500. Calculate interest under section 234D.

Solution

Period of Interest: 6 Months [i.e., 01.03.2019 to 31.08.2019]

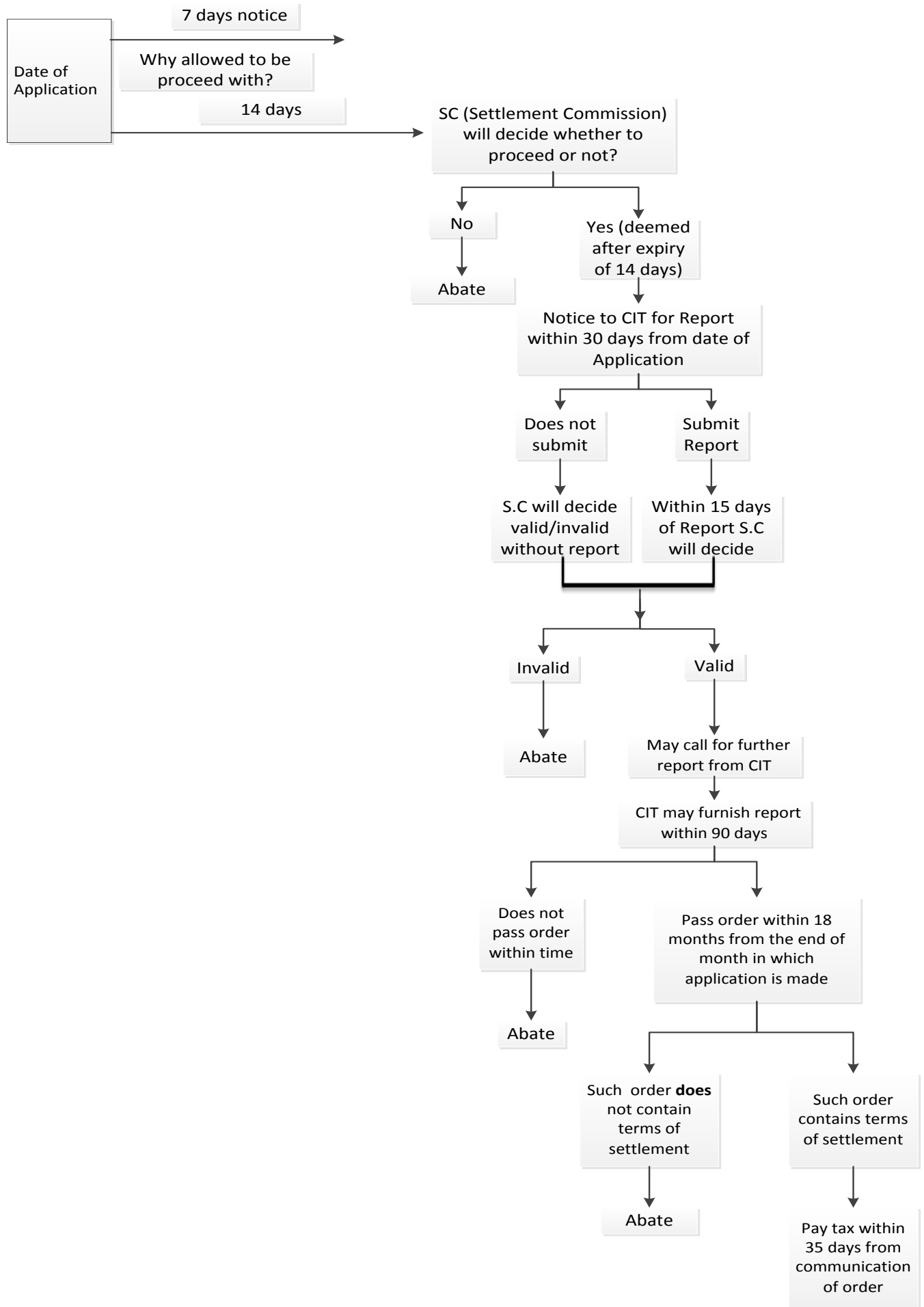
Interest under section 234D is Rs.720 (i.e., 21,000 x $\frac{1}{2}$ % x 6).

Readers Note:

30 - SETTLEMENT OF CASES

30.1 SETTLEMENT COMMISSION AT A GLANCE

1. There shall be a “case”.
2. An application in a prescribed form shall be made to Settlement Commission.
3. Such application shall be accompanied by the prescribed fees. (At present Rs. 500)
4. The application shall not be allowed to be withdrawn by the applicant.
5. The applicant shall make full and true disclosure to the Settlement Commission.
6. The application once made cannot be revised like “Revised return”. – **CIT v. Om Prakash Mital [2005] 143 Taxman 373 (SC)**
7. The application cannot be admitted unless “additional amount of income tax payable” exceeds specified amount.
8. Such “additional amount of tax payable” and interest thereon must be paid on or before making the application.
9. The proof of such payment is attached with the application.
10. The applicant must, on the date of making the application to the Settlement Commission, also intimate the Assessing Officer in prescribed manner, about having made an application to the Settlement Commission.



30.2 MEANING OF CASE**Section:- 245A(b)**

- **A pending proceeding is a "case"**

A "case" means any proceeding for assessment under the Act of any person, in respect of any assessment year which may be pending before the Assessing Officer on the date on which an application under section 245C(1) is made.

- **When a proceeding is taken as "pending proceeding"**

Sr. No.	Proceedings for	Date of commencement of proceedings	Date of conclusion of proceedings
1.	Assessment or reassessment or re-computation under section 147	From the date on which a notice u/s 148 is issued	No mention under the Act
2.	Any other assessment year or years for which a notice under section 148 has not been issued, but such notice could have been issued on such date, if the return of income for the other assessment year or assessment years has been furnished u/s 139 or in response to a notice u/s 142	From the date on which a notice under section 148 is issued in Case No. 1 above.	No mention under the Act
3.	Search Cases (i.e. Section 153A or 153C)	From the date of issue of notice requiring assessee to file returns for six assessment years	The date on which assessment is made. *
4.	Making fresh assessment in pursuance of an order under section 254 or section 263 or section 264, setting aside or cancelling an assessment	From the date on which order under section 254 or 263 or 264, setting aside or cancelling the assessment is passed	No mention under the Act
5.	Other cases – if assessment is made	from the date on which return of income is furnished under section 139 or in response to a notice under section 142	The date on which assessment is made.*
	Other Cases – If assessment is not made	from the date on which return of income is furnished under section 139 or in response to a notice under section 142	Time specified for completion of assessment under section 153(1)- Substituted by Finance Act, 2017 w.e.f. 1-4-2017

* The assessment proceedings shall be deemed to have been completed only on the date of service of assessment order to the applicant. – Circular No. 3/ 2008, dated 12th March, 2008.

Practical 1

Whether following proceedings shall be taken as “case” for the purpose of Settlement commission?

1. Proceedings initiated by issuing notice under section 143(2) of Income Tax Act
2. Proceedings initiated by issuing notice under section 271(1)(c) of Income Tax Act
3. Proceeding initiated by issuing notice under section 148 of Income Tax Act
4. Appellate proceedings pending before CIT(A) under section 246A of Income Tax Act

Solution

Considering the definition of case discussed above,

Sr. No.	Nature of pending Proceeding	Solution	Reason
1.	Proceedings initiated by issuing notice under section 143(2) of Income Tax Act	It is a “Case”	It is an assessment proceeding.
2.	Proceedings initiated by issuing notice under section 271(1)(c) of Income Tax Act	Not a “Case”	Not an assessment proceeding, it is a penalty proceeding.
3.	Proceeding initiated by issuing notice under section 148 of Income Tax Act	It is a “Case”	It is a reassessment proceeding.
4.	Appellate proceedings pending before CIT(A) under section 246A of Income Tax Act	It is not a “Case”	Not an assessment proceeding, It is an appellate proceedings.

Readers Note:

31 - ADVANCE RULINGS

31.1 APPLICATION FOR ADVANCE RULING

Section:- 245Q – Effective from 1st April 2018

- (1) An applicant desirous of obtaining an advance ruling under this Chapter ~~[or under Chapter V of the Customs Act, 1962]~~ **[Amendment made by Finance Act, 2018 – w.e.f. 1st April 2018]** or under Chapter IIIA of the Central Excise Act, 1944 or under Chapter VA of the Finance Act, 1994 may make an application in such form and in such manner as may be prescribed, stating the question on which the advance ruling is sought.
- (2) The application shall be made in quadruplicate and be accompanied by a fee of ten thousand rupees or such fee as may be prescribed in this behalf, whichever is higher.
- (3) An applicant may withdraw an application within thirty days from the date of the application.

31.2 CONSTITUTION OF AUTHORITY OF ADVANCE RULING

Section:- 245-O - Effective from 1st April 2018

Section 245-O has been amended with effect from October 1, 2014. The amended provisions are given below

1. The Central Government shall constitute an Authority for giving advance rulings, to be known as "Authority for Advance Rulings".

Provided that the Authority shall cease to act as an Authority for Advance Rulings for the purposes of Chapter V of the Customs Act, 1962 on and from the date of appointment of the Customs Authority for Advance Rulings under section 28EA of that Act.

Provided that the Authority shall not admit any appeal against any ruling or order passed earlier by it in the capacity of the Authority for Advance Rulings in relation to any matter under Chapter V of the Customs Act, 1962 after the date of such appointment of the Customs Authority for Advance Rulings.

2. The Authority shall consist of a Chairman and such number of Vice-chairmen, Revenue Members and Law Members as the Central Government may by notifications appoint.
3. A person shall be qualified for appointment as –

Chairman	Who has been a Judge of the Supreme Court or the Chief Justice of a High Court or at least seven years a Judge of a High Court
Vice-Chairman	Who has been Judge of a High Court
Revenue Member	(i) From the Indian Revenue Service, who is, or is qualified to be, a Member of the Board, (ii) From the Indian Customs and Central Excise Service, who is, or is qualified to be, a Member of Central Board of Excise and Customs, on the date of occurrence of a vacancy.
Law Member	From the Indian Legal Service, who is, <i>or is qualified to be</i> , an Additional Secretary to the Government of India on the date of occurrence of a vacancy.

4. The terms and conditions of service and the salaries and allowances payable to the Members shall be such as may be prescribed.

5. The Central Government shall provide to the Authority with such officers and employees, as may be necessary, for the efficient discharge of the functions of the Authority under the Act.
6. The powers and functions of the Authority may be discharged by its Benches as may be constituted by the Chairman from amongst the Members thereof.
7. In the event of the occurrence of any vacancy in the office of the Chairman by reason of his death, resignation or otherwise, the senior-most Vice-chairman shall act as the Chairman until the date on which a new Chairman, appointed in accordance with the provisions of this Act to fill such vacancy, enters upon his office.
8. In case the Chairman is unable to discharge his functions owing to absence, illness or any other cause, the senior-most Vice-Chairman shall discharge the functions of the Chairman until the date on which the Chairman resumes his duties.]
9. A Bench shall consist of the Chairman or the Vice-chairman and one revenue Member and one law Member.

Provided that where the Authority is dealing with an application seeking advance ruling in any matter relating to this Act, the revenue Member of the Bench shall be from the Indian Revenue Service, who is, or is qualified to be, a Member of the Board.

10. The Authority shall be located in the National Capital Territory of Delhi and its Benches shall be located at such places as the Central Government may, by notification specify.

32 - REQUIREMENT AS TO MODE OF ACCEPTANCE PAYMENT OR REPAYMENT IN CERTAIN CASES TO COUNTERACT EVASION OF TAX

32.1 MODE OF UNDERTAKING TRANSACTIONS

Section:- 269ST

No person shall receive an amount of two lakh rupees or more—

- (a) in aggregate from a person in a day; or
- (b) in respect of a single transaction; or
- (c) in respect of transactions relating to one event or occasion from a person, otherwise than by an account payee cheque or an account payee bank draft or use of electronic clearing system through a bank account:

Provided that the provisions of this section shall not apply to—

- (i) any receipt by—
 - (a) Government;
 - (b) any banking company, post office savings bank or co-operative bank;
- (ii) transactions of the nature referred to in section 269SS;
- (iii) such other persons or class of persons or receipts, which the Central Government may, by notification in the Official Gazette, specify.

Practical 1

From the given information, ascertain the violation of provisions of section 269ST of the Act, if any.

- (a) ABC Private Limited made following cash sales on “15th August” to following customers.

Name of the Customer	Bill No.	Rs.
Mr. Hasmukh	32	60,000
Mr. Mansukh	35	80,000
Mr. Hasmukh	48	1,50,000
Mr. Mansukh	59	40,000

- (b) PQR Private Limited has made credit Sales to Mr. Narendra for Rs. 8,00,000 on 1st August, 2017. Mr. Narendra discharged his liability in following manner :-

Date of Payment	Mode of Payment	Rs.
5th August, 2017	Account Payee Cheque	3,00,000
18th August, 2017	Cash	1,50,000
19th September, 2017	Bearer Cheque	1,60,000
10th October, 2017	RTGS (ECS)	1,90,000

- (c) Mr. Jagga received following payments in cash from Mr. Shetty on the occasion of marriage of Anushka (daughter of Mr. Shetty):

Date of Payment	Work undertaken by Mr. Jagga	Amount
18 th August, 2017	Decoration	1,45,000
20 th August, 2017	Video Shooting	1,05,000

Solution

- (a) The provisions of section 269ST restrict acceptance of Rs. two lakh or more in aggregate from a person in a day otherwise than by an account payee cheque or an account payee draft or ECS. However, this limit is person-wise day-wise. Therefore, ABC Private limited committed violation of section 269ST in respect of cash sales made to Mr. Hasmukh since aggregate amount exceeded Rs.2,00,000 .
- (b) The provision of section 269ST restrict acceptance of Rs. two lakh or more in respect of single transaction otherwise than by an account payee cheque or an account payee draft or ECS. Therefore, PQR private limited committed violation of section 269ST in respect of single transaction done with Mr. Narendra by accepting Rs. 3,10,000 (Rs. 1,50,000 in cash and Rs. 1,60,000 bearer cheque).
- (c) The provisions of section 269ST restrict acceptance of Rs. two lakh or more in aggregate in respect of transactions relating to one event or occasion from a person otherwise than by an account payee cheque or an account payee draft or ECS. Therefore, Mr. Jagga committed violation of section 269ST in respect of transactions relating to marriage event of Anushka by accepting Rs. 2,50,000 (Rs. 1,45,000 for decoration and Rs. 1,05,000 for video shooting) in cash.

Readers Note:

32.2	PRESS RELEASE, CIRCULARS AND NOTIFICATIONS

1. Press release dated 5th April 2017

The CBDT has issued a press release dated 5th April 2017 by which it has provided important clarification regarding the restriction imposed on cash transaction by sections 269ST & 271DA inserted by the Finance Act 2017 to the Income-tax Act. These sections provide that no person (other than those specified therein) shall receive an amount of two lakh rupees or more (a) in aggregate from a person in a day; (b) in respect of a single transaction; or (c) in respect of transactions relating to one event or occasion from a person, otherwise than by an account payee cheque or account payee bank draft or use of electronic clearing system through a bank account. **The CBDT has clarified that the said cash transaction limit of Rs 2 lakh will not apply to withdrawal from banks, cooperative bank and post offices.**

2. Circulars**Circular No. 22 of 2017 Dated 03rd July, 2017****Clarifications in respect of section 269ST of the Income-tax Act, 1961**

- (a) Representations have been received from non-banking financial companies (NBFCs) and housing finance companies (HFCs) as to whether the provisions of section 269ST of the Act shall apply to one instalment of loan repayment or the whole amount of such repayment.
- (b) **In this context, it is clarified that in respect of receipt in the nature of repayment of loan by NBFCs or HFCs, the receipt of one instalment of loan repayment in respect of a loan shall constitute a 'single transaction' as specified in clause (b) of section 269ST of the Act and all the instalments paid for a loan shall not be aggregated for the purposes of determining applicability of the provisions section 269ST.**

33 - PENALTIES

33.1 FURNISHING INCORRECT INFORMATION IN ANY REPORT OR CERTIFICATE BY AN ACCOUNTANT OR A MERCHANT BANKER OR A REGISTERED VALUER
Section:- 271J

Nature of default	Penalty leviable	Competent IT Authority to levy penalty
Where the Assessing Officer or the Commissioner (Appeals), finds that an accountant or a merchant banker or a registered valuer has furnished incorrect information in any report or certificate furnished under any provision of this Act or the rules made thereunder.	Rs. 10,000 for each such report or certificate.	Assessing Officer / CIT(A)

No penalty is imposable for any failure under sections 271(1)(b), 271A, 271AA, 271B, 271BA, 271BB, 271C, 271CA, 271D, 271E, 271F, 271FA, 271FAB, 271FB, 271G, 271GA, 271GB, 271H, 271-I, 271J, 272A(1)(c) or (d), 272A(2), 272AA(1), 272B, 272BB(1), 272BB(1A), 272BBB(1), 273(1)(b), 273(2)(b) and 273(2)(c) if the person proves that there was reasonable cause for such failure (section 273B).

33.2 PENALTY ON THE BASIS OF MISREPORTING /UNDER REPORTED OF INCOME
Section:- 270A

Section 270A has been inserted from the assessment year 2017-18. Under this section, the Assessing Officer, CIT (Appeals) or the Principal CIT or CIT may, during the course of any proceedings under this Act, levy penalty if a person has under – reported his income.

Step 1: Cases of under-reported income

- the income assessed is greater than the income determined in the return processed under section 143(1)(a);
- the income assessed is greater than the maximum amount not chargeable to tax, where no return of income has been furnished;
- the income **reassessed** is greater than the income assessed or reassessed immediately before such reassessment;
- the amount of deemed total income assessed or reassessed under section 115JB or section 115JC is greater than the deemed total income determined in the return processed under section 143(1)(a);
- the amount of deemed total income assessed as per the provisions of section 115JB or section 115JC is greater than the maximum amount not chargeable to tax, where no return of income has been filed;
- the amount of deemed total income **reassessed** as per the provisions of section 115JB or section 115JC is greater than the deemed total income assessed or reassessed immediately before such reassessment;
- the income assessed or reassessed has the effect of reducing the loss or converting such loss into income.

Under-reported income shall not include the following-

- Where the assessee offers an explanation and the income-tax authority is satisfied that the explanation is bonafide and all the material facts have been disclosed;
- Where such under-reported income is determined on the basis of an estimate, if the accounts are correct and complete but the method employed is such that the income cannot properly be deducted therefrom;

- c. Where the assessee has, on his own, estimated a lower amount of addition or disallowance on the issue and has included such amount in the computation of his income and disclosed all the facts material to the addition or disallowance
- d. Where the assessee had maintained information and documents as prescribed under section 92D, declared the international transaction and disclosed all the material facts relating to the transaction;

Where the undisclosed income is on account of a search operation and penalty is leviable under section 271AAB.

Step 2: Quantum of under-reported income

The amount of under-reported income shall be determined as follows-

Sr. No.	Different situations	Quantum of under-reported income
1.	In a case where income has been assessed for the first time, and	
	(a) Return has been furnished	The difference between the income assessed and the income determined under section 143(1)(a).
	(b) Return has not been furnished	- In the case of a company, firm or local authority; The amount of income assessed,
		- In any other case:- The difference between the income assessed and the maximum amount not chargeable to tax.
2.	Where income is not assessed for the first time	The difference between the income assessed/reassessed/ recomputed and the amount of income assessed/reassessed/recomputed in a preceding order
3.	Where an assessment /reassessment has the effect of reducing the loss declared in the return or converting that loss into income	The difference between the loss claimed and the income (or loss) as assessed / reassessed
4.	Where under-reported income arises out of determination of deemed income in accordance with the provisions of section 115JB/115JC	(A-B) + (C-D)

Calculation of under-reported income in case of applicability of provision of sections 115JB/JC- It shall be determined on the basis of the following formula-

Under-report income = (A-B) +(C-D)

- A = the total income assessed as per the provisions other than the provisions contained in section 115JB or section 115JC (herein called general provisions);
- B = the total income that would have been chargeable had the total income assessed as per the general provisions been reduced by the amount of under-reported income;
- C = the total income assessed as per the provisions contained in section 115JB or section 115JC
- D = the total income that would have been chargeable had the total income assessed as per the provisions contained in section 115JB or section 115JC been reduced by the amount of under-reported income:

Remark: where the amount of under-reported income on any issue is considered both under the provisions contained in section 115JB or section 115JC and under general provisions, such amount shall not be reduced from total income assessed while determining the amount under item D.

Step 3: How to calculate tax on under-reported income: The tax payable on under-reported income shall be calculated as follows-

Different situations	Mode of computation of tax on under-reported income
Case 1- where no return has been furnished and the income has been assessed for the first time	Amount of tax computed on (under-reported income + exemption limit)
Case 2- where total income determined under section 143(1)(a) or assessed/reassessed/re-computed in a preceding order is a loss	Amount of tax computed on under-reported income, as if it were total income
Case 3-In any other case	Tax on under-reported income is (x-y) x=amount of tax computed on [under-reported income + total income determined under section 143(1)(a) or total income assessed /reassessed / recomputed in a preceding order] y=amount of tax computed on total income determined under section 143(1)(a) or total income assessed/reassessed/recomputed in a preceding order]

Step 4: Computation of penalty under section 270A:

The rate of penalty shall be 50 percent of the tax payable on under-reported income. (Step 3)

However, in cases of under-reported income falling under misreporting of income, penalty shall be 200 percent of the tax payable on such misreporting of income

Misreporting of income [Section 270A(9)]- cases of misreporting of income shall be the following-

- misrepresentation or suppression of facts;
- failure to record investments in the books of account;
- claim of expenditure not substantiated by any evidence;
- recording of any false entry in the books of account;
- failure to record any receipt in books of account having a bearing on total income; and
- 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 apply.

33.3 IMMUNITY FROM IMPOSITION OF PENALTY

Section:- 270AA

- An assessee may make an application under section 207AA to the Assessing Officer to grant immunity from imposition of penalty under section 270A and initiation of proceedings u/s 276C or 276CC.
- The assessee can make an application subject to following conditions:
 - The assessee pays tax and interest payable as per the order of assessment/reassessment order under section 143(3)/147 within the period specified in such notice of demand and does not prefer an appeal against such assessment order and
 - The assessee makes such application in a prescribed form within 1 month from the end of the month in which the order of assessment or reassessment is received.

- The Assessing Officer shall, on fulfilment of the above conditions and after the expiry of the period of filing the appeal as specified in section 249(2), grant immunity from penalty proceedings under section 270A and initiation of proceedings under section 276C.
- However, immunity shall not be granted for penalty under section 270A(9) of the Act.
- The Assessing Officer is required to pass an order accepting (or rejecting) such application, within a period of 1 month from the end of the month in which such application is received. However, the Assessing Officer shall give an opportunity of being heard before rejecting the application.
- The order passed under this section shall be final.
- No appeal under section 246A or an application for revision under section 264 shall be admissible against the order of the assessment or reassessment in a case where the order granting immunity is passed.

Practical 1

ABC & Co., a partnership firm was subject to assessment / reassessment for the **A.Y.2018-19**. Following are the details of income determined at various stages of assessment / reassessment proceedings:

Sr. No.	Particulars of Income	Rs.
1.	As per the return of income furnished u/s 139(1)	10,00,000
2.	Determined under section 143(1)(a)	20,00,000
3.	Assessed under section 143(3)	35,00,000
4.	Reassessed under section 147	55,00,000

Compute the penalty leviable u/s 270A, if any assuming that under-reporting is not on account of misreporting.

Solution**Computation of penalty leviable under section 270A**

Particulars	Rs.	Rs.
<u>Assessment under section 143(3)</u>		
<u>Under-reported income:</u>		
Total income assessed under section 143(3)	35,00,000	
(-) Total income determined u/s 143(1)(a)	20,00,000	
	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. 20 lakhs determined u/s 143(1)(a) [30% of Rs. 35 lakh + EC & SHEC@3%]	10,81,500	
Less: Tax on total income determined u/s 143(1)(a) [30% of Rs. 20 lakh + EC & SHEC@3%]	6,18,000	
	4,63,500	
Penalty leviable@50% of tax payable		2,31,750
<u>Reassessment under section 147</u>		
<u>Under-reported income:</u>		
Total income reassessed under section 147	55,00,000	

(-) Total income assessed under section 143(3)	35,00,000	
	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. 35 lakhs assessed u/s 143(3) [30% of Rs. 95 lakh + EC & SHEC@3%]	16,99,500	
Less: Tax on total income assessed u/s 143(3) [30% of Rs. 35 lakh + EC & SHEC@3%]	10,81,500	
	6,18,000	
Penalty leviable@50% of tax payable		3,09,000

Readers Note:**Practical 2**

Find out penalty leviable, if any, under section 270A of the Act in the hands of Mr. Rahim (35 years) who was assessed under section 144 of the Act since he had not filed the return of income for the **A.Y. 2018-19** and also suppressed the facts relating to his income. The assessing officer determined total income at Rs. 10 lakh.

Solution**Computation of penalty leviable under section 270A**

Particulars	Rs.	Rs.
<u>Assessment under section 143(3)</u>		
<u>Under-reported income:</u>		
Total income assessed under section 144	10,00,000	
(-) Basic exemption limit	2,50,000	
	7,50,000	
Tax payable on under-reported income as increased by the basic exemption limit [i.e. tax on (Rs. 7.5 lakh Plus Rs. 2.5 Lakh)]	1,12,500	
Add: EC & SHEC@3%	3,375	
	1,15,875	
Penalty leviable@200% of tax payable		2,31,750

Readers Note:**Practical 3**

DEF Ltd. was subject to various assessment / re-assessment for the **A.Y. 2018-19**. Following are the details of income determined at various stages of assessment / reassessment proceedings.

Sr. No.	Particulars of Income	Rs.
1.	As per the return of income furnished u/s 139(1)	(6,00,000)
2.	Determined under section 143(1)(a)	(3,00,000)
3.	Assessed under section 143(3)	(1,00,000)
4.	Reassessed under section 147	4,00,000

Compute the penalty leviable u/s 270A, if any assuming that under-reporting is not on account of misreporting

Solution

Computation of penalty leviable under section 270A

Particulars	Rs.	Rs.
<u>Assessment under section 143(3)</u>		
<u>Under-reported income:</u>		
Loss assessed u/s 143(3)	(1,00,000)	
(-) Loss determined under section 143(1)(a)	(3,00,000)	
	2,00,000	
Tax payable on under-reported income@30%	60,000	
Add: EC & SHEC@3%	1,800	
	61,800	
Penalty leviable@50% of tax payable		30,900
<u>Reassessment under section 147</u>		
<u>Under-reported income:</u>		
Total income reassessed under section 147	4,00,000	
(-) Loss assessed under section 143(3)	(1,00,000)	
	5,00,000	
Tax payable on under-reported income@30%	1,50,000	
Add: EC & SHEC@3%	4,500	
	1,54,500	
Penalty leviable@50% of tax payable		77,250

Readers Note:

33.4 POWERS OF PRINCIPAL COMMISSIONER OR COMMISSIONER TO WAIVE OR REDUCE PENALTY FOR UNDERREPORTING AND MISREPORTING OF INCOME

Section:- 273A(1)

- The Principal Commissioner or Commissioner may in his discretion, either on his own motion or otherwise (i.e., on an application made by the assessee), reduce or waive the amount of penalty imposed or imposable for underreporting and misreporting of income, if he is satisfied that
 - (a) the person liable to penalty has, prior to the detection by the Assessing Officer, of the concealment of particulars, of income or inaccuracy of particulars furnished in respect of such income voluntarily and in good faith, made full and true disclosure of such particulars, and
 - (b) has also co-operated in any enquiry relating to the assessment of his income
 - (c) and has either paid or made satisfactory arrangement for the payment of any tax or interest payable in consequence of an order passed in respect of the relevant assessment year.[Section 273A (1)]

- Prior approval of Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General is required in case of amount of income in respect of which penalty imposed or imposable for the assessment year (aggregate basis if it relates to more than one assessment year) exceeds Rs. 5 lac.
- Where an order has been made under section 273A(1) in favour of any person, he shall not be entitled to any relief under this section (means entire section 273A) in relation to any other assessment year at any time after the making of such order.

33.5 POWERS OF COMMISSIONER TO WAIVE OR REDUCE PENALTY IN CASE OF GENUINE HARDSHIP

Section:- 273A(4)

- The Commissioner may, on an application made in this behalf by an assessee, and after recording his reasons for doing so, reduce or waive the amount of any penalty payable by the assessee, or stay or compound any proceeding for the recovery of any such amount, if he is satisfied that
 - (a) to do otherwise, would cause genuine hardship to the assessee, having regard to the circumstances of the case, and
 - (b) the assessee has co-operated in any inquiry relating to the assessment and any proceeding for the recovery of any amount due from him.[Section 273A (4)]
- Prior approval of Principal Chief Commissioner or Chief Commissioner or Principal Director General or Director General is required in case of amount of penalty imposed or imposable for the assessment year (aggregate basis if it relates to more than one assessment year) exceeds Rs. 1 lac.
- The above order under section 273 A(1) or section 273 A(4), as the case may be, either accepting or rejecting the application in full or in part, shall be passed within a period of twelve months from the end of the month in which the application is received by the Principal Commissioner or the Commissioner.
- However, 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.
- Any application which is pending as on the 1st day of June, 2016, the order shall be passed on or before the 31st day of May, 2017.
- Andhra Pradesh High Court in case of K.S.N. Murthy v. Chairman, CBDT (2001) 252 ITR 269, held that, if the above two conditions are satisfied, the Commissioner has no discretion to refuse to exercise his powers.

33.6 TIME LIMIT FOR IMPOSITION OF PENALTY

Section:- 275

- **Situation (1) – Section 275(1)(a):- In a case where the relevant assessment or other order is the subject-matter of an appeal to the Commissioner (Appeals) under section 246 or section 246A,**
Time limit:- An order imposing penalty shall be passed
 - (a) before the expiry of the financial year in which the proceedings, in the course of which action for imposition of penalty has been initiated, are completed, or
 - (b) within one year from the end of the financial year in which the order of the Commissioner (Appeals) is received by the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner,
 whichever is later
- **Situation (2) – Section 275(1)(a):- In a case where the relevant assessment or other order is the subject-matter of an appeal to the Appellate Tribunal under section 253,**
Time limit:- An order imposing penalty shall be passed

- (a) before the expiry of the financial year in which the proceedings, in the course of which action for the imposition of penalty has been initiated, are completed, or
 - (b) six months from the end of the month in which the order of the Appellate Tribunal is received by the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner, whichever is later
- **Situation (3) – Section 275(1)(b):- In a case where the relevant assessment or other order is the subject-matter of revision under section 263 or section 264,**
Time limit:- An order imposing penalty shall be passed before the expiry of six months from the end of the month in which such order of revision is passed.
 - **Situation (4) – Section 275(1)(c):- In any other case,**
Time limit:- An order imposing penalty shall be passed
 - (a) before the expiry of the financial year in which the proceedings, in the course of which action for the imposition of penalty has been initiated, are completed, or
 - (b) six months from the end of the month in which action for imposition of penalty is initiated, whichever period expires later.

Practical 4

The assessment for assessment year 2017-18 was completed by the Assessing Officer on 15-5-2018 in which he made an addition of Rs.1,00,000 on account of under reported income. Penalty proceeding were initiated under section 271(1)(c) on the same date. Determine the limit for imposing the penalty if:

- (a) No appeal is filed by the assessee;
- (b) The assessee files an appeal and the appellate order was passed on 24-3-2019 which was received by the Commissioner on 3-4-2019.

Solution

(a)	If no appeal is filed by the assessee.	(i) On or before the expiry of the financial year in which assessment proceedings are completed. [31.03.2019] OR (ii) 6 months from the end of the month in which action for imposition of penalty have been initiated. [30.11.2018]	WHICHEVER IS LATER i.e., 31.03.2019
(b)	If Appeal has been filed by the assessee.	(i) On or before the expiry of the financial year in which assessment proceedings are completed [31.03.2019] OR (ii) 1 year from the end of financial year in which order of CIT (A) is received by CIT. [31.03.2021]	WHICHEVER IS LATER i.e., 31.03.2021

Readers Note:

34 - PROSECUTIONS**34.1 OFFENCES AND PROSECUTIONS****Section:- 276CC – Effective from 1st April 2018**

Section	Nature of default	Punishment (rigorous imprisonment)
276CC	Willful failure to furnish return of income under section 139(1) or in response to notice under section 142(1)(i) or section 148 or section 153A (non-cognizable offence under section 279A)— (a) where tax sought to be evaded exceeds Rs.25 lakh (b) in other cases	 6 months to 7 years 3 months to 2 years

Proviso to section 276CC

The person shall not be proceeded against under section 276CC in a case where the return of income is not filed within the due date under section 139(1), if

- (a) The return is furnished by him before the expiry of the assessment year; or
- (b) 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 Rs.3,000.

This proviso will not be applicable in case of company [Amended by Finance Act, 2018 w.e.f. 1st April 2018]

Practical 1

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.2014-15 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 Rs. 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 Rs. 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.

Does your answer differ, if assessee would have been M/s. KLM Private Limited instead of partnership firm?

35 - CONVERSION OF FIRM INTO COMPANY

36 - CONVERSION OF SOLE PROPRIETARY BUSINESS INTO COMPANY

37 - AMALGAMATION

**38 - SET OFF OF LOSSES OF A BANKING COMPANY AGAINST THE PROFIT OF
A BANKING INSTITUTION UNDER A SCHEME OF AMALGAMATION**

39 - DEMERGER

40 - AMALGAMATION OR DEMERGER OF THE CO-OPERATIVE BANKS

41 - CORPORATISATION AND DEMUTUALISATION OF STOCK EXCHANGE

42 - CONVERSION OF UNLISTED COMPANY INTO LLP

**43 - TRANSFER OF ASSETS BETWEEN HOLDING AND SUBSIDIARY
COMPANIES**

44 - SLUMP SALE

44.1 DEFINITION

Section:- 2(42C)

“Slump sale means *the transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales.*”

44.2 TAX CONSEQUENCES UNDER THE HEAD "CAPITAL GAINS"

Section:- 50B

The provisions of section 50B, applicable for computation of capital gains in the case of slump sale, are given below—

- (a) Any profits or gains arising from the slump sale affected in the previous year shall be chargeable as long-term capital gains and shall be deemed to be the income of the previous year in which the transfer took place.

Where, however, any capital asset being one or more undertakings owned and held by the assessee for not more than 36 months is transferred under the slump sale, then capital gain shall be deemed to be short-term capital gain.

- (b) In the case of slump sale of the capital asset being one or more undertaking, the "net worth" of the undertaking shall be taken as cost of acquisition and cost of improvement. "Net worth" for this purpose is the aggregate value of total assets of the undertaking or division as reduced by the value of liabilities of such undertaking or division as appearing in the books of account.

Computation of net worth shall be as under—

Particulars	Base of Valuation
Depreciable Assets	sub-item (C) of Section 43(6)(c)(i)
Capital Assets u/s 35AD	Nil
Other Assets	Book Value
Sub Total	XXXXXXXXXX
Less: Liabilities	Book Value
Net worth	YYYYYYYYYYY

Any change in the value of assets on account of revaluation of assets shall be ignored for the purpose of computing the net worth.

- (c) The benefit of indexation will not be available.
- (d) Every assessee, in the case of slump sale, shall furnish along with the return of income, a report of a chartered accountant in Form No. 3CEA indicating the computation of the net worth of the undertaking or division, as the case may be, and certifying that the net worth of the undertaking or division, as the case may be, has been correctly arrived at.

44.3 STEPS TO FIND OUT WRITTEN DOWN VALUE IN THE HANDS OF TRANSFEROR AFTER SLUMP SALE

Sections:- 43(6)(c)(i)

Step 1	Find out the depreciated value of the block at the beginning of the previous year.
Step 2	Add "actual cost" of the asset acquired during the previous year.
Step 3	Balance
Step 4	Deduct money received/receivable (together with scrap value) in respect of that asset (falling within the block of assets) which is sold, discarded, demolished or destroyed during the previous year. (Step 4 amount shall not exceed Step 3 amount)
Step 5	Find out Balance
Step 6- is called Sub item (C) of Section 43(6)(c)(i)	Deduct WDV of assets transferred under slump sale as if it is the only asset in a block (Step 6 amount shall not exceed Step 5 amount)
Step 7	WDV in the hands of transferor after slump Sale

Practical 1

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	Rs. in lacs	Assets	Rs. 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 (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 31.03.2018. (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 u/s 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?

Solution

- (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	Rs. in lacs
Sale consideration for slump sale of Software Unit	385
Less: Cost of acquisition being the networth 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 Rs.200 lacs	40.00
Add: Surcharge @7%	2.80
	42.80
Add: Education cess@2% and SHEC @1%	1.28
	44.08

Working Note:- Computation of net worth of Software Unit

Particulars	Rs. 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) (Refer Note)	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.

Readers Note:

45 –DEPRECIATION

45.1 MEANING OF ACTUAL COST

Section:- 43(1) – Amendment made by Finance Act, 2018 w.e.f A.Y. 2019-20

EXPLANATION 1A TO SECTION 43(1)

Situation	Notional cost under-section 43(1)
Where the inventory is converted into capital asset and is used for the purposes of business or profession.	Then, the actual cost of such asset to the assessee shall be the fair market value which has been taken into account for the purposes of the conversion.

Practical 28

ABC Ltd. is engaged in manufacturing “8 Color C.I. Flexo Printing Machines” since 10 years. The company set up “Printing Service Division” and decided to provide printing services on polyethylene films and therefore shifted five machines to “Printing Service Division”. The book value of each such machine was Rs. 1 Cr. though fair market value was Rs. 1.40 Cr. Find out the

- business gain arising from this transaction
- actual cost of each machine for the purpose of computing depreciation under section 32 of the Act.

Solution

(a)

Computation of Business Gain

Particulars	Rs. in crores
Fair Market Value [Rs.1.40 crores x 5 machines]	7.00
Less: Book Value [Rs.1 crore x 5 machines]	5.00
Business Gain	2.00

- As per explanation 1A to section 43(1), the actual cost of each machine for the purpose of calculating depreciation under section 32 shall be the fair market value i.e., 1.4 crore.

Readers Note:

46 – TAX PLANNING, TAX AVOIDANCE AND TAX EVASION

47 – TONNAGE TAXATION SCHEME

47.1 HOW TO COMPUTE TONNAGE INCOME UNDER “TTS”?

Section:- 115VE, 115VF and 115G

- **Computation of TTS income:-** Income taxable under the TTS shall be the aggregate of the tonnage income ('TI') computed for each qualifying ship as follows:

- **TI for each qualifying ship**

TI for each qualifying ship = $\frac{\text{Daily TI based on net tonnage of the qualifying ship}}{\text{the number of days in the previous year or the number of days for which the ship operates as a qualifying ship during the previous year if the ship is so operated for part of the year (as the case may be)}}$

- The daily TI based on the net tonnage for each qualifying ship is as follows:

Net tonnage	Amount of daily TI
Up to 1,000	Rs. 70 for each 100 tons
1,001 - 10,000	Rs. 700 plus Rs. 53 for each additional 100 tons
10,001 - 25,000	Rs. 5,470 plus Rs. 42 for each additional 100 tons
Above 25,000	Rs. 11,770 plus Rs. 29 for each additional 100 tons

Notes:

- (1) The tonnage shall be rounded off to the nearest multiple of 100 tons and for this purpose:

(a) any tonnage consisting of kilograms shall be ignored and thereafter

(b) if such tonnage is not a multiple of 100 and if the last figure in that amount is:-

- **50 tons or more**, the tonnage shall be increased to **the next higher tonnage** which is a multiple of 100; and
- if the last figure is **less than 50 tons**, the tonnage shall **be reduced to the previous lower tonnage** which is a multiple of hundred.

- (2) **Tonnage Means** tonnage of the ship as per valid certificate *plus* **Deemed tonnage**.

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.

- (3) Joint operation [Section 115VH] - In case of joint operation of a qualifying ship by two or more companies, where the **respective shares are definite** and ascertainable, then the tonnage income of each such company shall be determined in proportion to their share.

- (4) If **shares are not ascertainable**, then tonnage income shall be computed as if each had been the only operator.

Practical 1

Find out Tonnage income of the ABC LTD. on the basis of following information:

Qualifying Ships	A1	A2	A3	A4
Valid tonnage	930	9951	15568	25862
No. days for which ship was operated during the previous year	30	300	150	125

Solution

Qualifying Ships	A1	A2	A3	A4
(a) Valid tonnage (r/off)	900	10,000	15,600	25,900
(b) Daily tonnage income	Rs. 630	Rs. 5,470	Rs. 7,822	Rs. 12,031
(c) No. days for which ship was operated during the previous year	30	300	150	125
(d)= (b) × (c)	18,900	16,41,000	11,73,300	15,03,875

Total Tonnage Income of ABCD Limited= Rs. 43,37,075

Readers Note:

47.2 WHAT DO YOU MEAN BY RELEVANT SHIPPING INCOME? IS IT CHARGEABLE TO TAX?

Section:- 115VI

- Section 115VI provides that **Relevant Shipping Income** is a sum total of Profits from Core Activities and **Profits from Incidental Activities**.

Remarks:

- (1) In case the income from incidental activities exceeds 0.25% of the turnover from core activities, the excess shall not be regarded as relevant shipping income and shall be taxed as per the general provisions of the Act.
- (2) **The actual shipping income (termed as the relevant shipping income) shall not be chargeable to tax and shall also not be liable to MAT. (Section 115VF and Section 115VO).**
- (3) In case relevant shipping income is a loss, then, such loss shall be ignored for the purpose of computing tonnage income.

- Profits from Core Activities**

This would include activities from:-

- Operating qualifying ships, and
- Other ship related activities namely, shipping contracts in respect of pooling arrangements and contracts of affreightment; and specific shipping trades.

- "Pooling arrangement"** means an agreement between two or more persons for providing services through a pool or operating one or more ships and sharing earnings or operating profits on the basis of mutually agreed terms;
- "Contract of affreightment"** means a service contract under which a tonnage tax company agrees to transport a specified quantity of specified products at a specified rate, between designated loading and discharging ports over a specified period.
- Specific shipping trades are:**
 - on-board or on-shore activities of passenger ships comprising of fares and food and beverages consumed on board;
 - slot charters, space charters, joint charters, feeder services, container box leasing of container shipping.

However, the Central Government has power to exclude any activity from the other ship related activities or prescribe the limit up to which such activities shall be included in the core activities.

- **Profits From Incidental Activities**

These are prescribed activities which are incidental to core activities.

Computation of income from non-qualifying ships - In case a company which has opted for the TTS, operates any non-qualifying ship, the income attributable to such non-qualifying ship shall be computed in accordance with the general provisions of the Act.

Inter Unit transfer:- Where any goods or services held for the purpose of tonnage tax business are transferred to any other business carried on by tonnage tax company or vice-a-versa and, Consideration for such transfer as recorded in accounts of tonnage tax business does not correspond to the market value of such goods or services as on the date of transfer then, Relevant shipping income shall be computed as if the transfer had been made at the market value of such goods or services as on that date.

Practical 2

Tarun Shipping Co. Ltd., having its registered office in Mumbai, plies two ocean-going vessels which it owns. The registered tonnage of the two vessels are 47,516 tonnes and 200 kgs and 25,759 tonnes and 400 kgs respectively. In the accounting year 2018-19, the first vessel was operated for 360 days and the second for 200 days.

The accounts of the company reveal the following results:

- (i) Profit from core shipping activity Rs.90.50 Lac
- (ii) Profit from incidental activity Rs.15,000

Compute the tax payable by the company for the assessment year 2019-20, taking note of the provisions of the law relating to taxation of income of shipping companies. Also indicate the specified conditions for the applicability of the procedure. Ignore MAT

Solution

Computation of tax payable by Tarun Shipping Company Ltd. for the A.Y.2019-20

Particulars	Rs.
Tonnage income (See Working Note below)	89,86,600
Tax @ 30%	26,95,980
Add: Surcharge (Not applicable as the income is below Rs. 100 Lacs)	Nil
	26,95,980
Add: Education cess and SHEC @ 4%	1,07,839
Total tax payable	28,03,819

Working Note

Since the income under tonnage tax scheme is lower than the normal income of Rs. 90.50 Lacs, the tonnage tax scheme is taken for computing tax payable.

Computation of Tonnage Income [Section 115VG]

Particulars	Ship 1 (Rs.)	Ship 2 (Rs.)
First 1,000 tons (1000 x 70/100)	700	700
Next 9,000 tons (9,000 x 53/100)	4,770	4,770
Next 15,000 tons (15,000 x 42/100)	6,300	6,300
Balance [(22,500/800) x 29/100]	6,525	232
	18,295	12,002

Tonnage income	Rs.
Ship 1 (18,295 × 360)	65,86,200
Ship 2 (12,002 × 200)	24,00,400
	89,86,600

Note: Tonnage is to be rounded off to the nearest multiple of 100 tons. Hence, the first vessel will pay for 47,500 tons and the second for 25,800 tons.

As per section 115VF, the tonnage income computed under section 115VG would be deemed to be the profits chargeable under the head “Profits and gains of business or profession”. This is, however, subject to fulfillment of the conditions mentioned below in the next paragraph. Then, the relevant shipping income referred to in section 115-VI(1), which includes the profit from core shipping activity (i.e. Rs. 90.50 Lacs) and the profit from incidental activity (Rs.15,000), shall not be chargeable to tax.

The following are the conditions to be fulfilled by the company for applicability of the tonnage tax scheme-

- (i) An option to get assessed under Chapter XII-G has to be filed by the company.
- (ii) The company is required to credit to a reserve account called Tonnage Tax Reserve Account, at least 20% of the book profits derived from its core and incidental activities to be utilized before the expiry of a period of 8 years for acquisition of a new ship for the purposes of the business of the company. Until the acquisition of a new ship, the amount can be utilized for the purposes of the business of operating qualifying ships. However, the amount should not be used for distribution of dividends or profits or for remittance outside India as profit or for creation of assets outside India.

Readers Note:

48 - INCOME COMPUTATION AND DISCLOSURE STANDARDS (ICDS)**48.1 | METHOD OF ACCOUNTING IN CERTAIN CASES****Section:- 145A**

For the purpose of determining the income chargeable under the head "Profits and gains of business or profession", the following valuation rules will apply—

1. The valuation of inventory shall be made at lower of actual cost or net realisable value computed in the manner provided in ICDS.
2. The valuation of purchase and sale of goods or services and of inventory shall be adjusted to include the amount of any tax, duty, cess or fee (by whatever name called) actually paid or incurred by the assessee to bring the goods or services to the place of its location and condition as on the date of valuation.
3. The inventory (being securities not listed on a recognised stock exchange, or listed but not quoted on a recognised stock exchange) shall be valued at cost actual cost initially recognized in the manner provided in ICDS.
4. Inventory (being securities held by a scheduled bank or financial institution) shall be valued in accordance with ICDS after taking into account extant guidelines issued by RBI.
5. The inventory (being listed securities), shall be valued at lower of actual cost or net realisable value in the manner provided in ICDS and for this purpose the comparison of actual cost and net realizable value shall be done category-wise.
6. Any tax, duty, cess or fee (by whatever name called) under any law for the time being in force, shall include all such payment notwithstanding any right arising as a consequence to such payment for the purpose of the said section.

48.2 | TAXABILITY OF CERTAIN INCOME**Section:- 145B**

Section 145 provides mode of taxation of the following incomes-

- (1) Interest received by an assessee on any compensation or on enhanced compensation, as the case may be, shall be deemed to be the income of the previous year in which it is received.
- (2) The claim for escalation of price in a contract or export incentives shall be deemed to be the income of the previous year in which reasonable certainty of its realisation is achieved.
- (3) Assistance in the form of subsidy (or grant or cash incentive or duty drawback or waiver or concession or reimbursement) as referred to in section 2(24)(xviii) shall be deemed to be the income of the previous year in which it is received, if not charged to income-tax in any earlier previous year.

49 – LIABILITY IN SPECIAL CASES

50 – REFUND

50.1 WITHHOLDING OF REFUND IN CERTAIN CASES**Section:- 241A**

For every assessment year commencing on or after the 1st day of April, 2017, where refund of any amount becomes due to the assessee under section 143(1) of the Act and the Assessing Officer is of the opinion, having regard to the fact that a notice has been issued under section 143 (2) of the Act in respect of such return, that the grant of the refund is likely to adversely affect the revenue, he may, for reasons to be recorded in writing and with the previous approval of the Principal Commissioner or Commissioner, as the case may be, withhold the refund up to the date on which the assessment is made.

50.2 INTEREST ON REFUNDS**Section:- 244A**

- Sub - Section (1)**

Where refund of any amount becomes due to the assessee under this Act due to following reasons, he shall be entitled to receive, in addition to the refund amount, simple interest @ 0.5% for every month or part of a month thereon, calculated in the following manner:-

Reasons giving rise to a refund	Period for grant of interest on refund		No interest shall be payable
	Commencing from	Ending on	
Where the refund is out of TCS u/s 206C or paid by way of advance tax or treated as paid u/s 199 (due to TDS provisions).			
(a) Where the return is filed on or before the due date u/s 139(1)	1 st April of the assessment year	Date of grant of refund	However, no interest shall be payable if the amount of refund due is less than 10% of the tax determined under section 143(1) or on regular assessment.
(b) Where the return is filed after the due date (Belated Return)	the date of filing of return	Date of grant of refund	
Where the refund is out of self-assessment tax paid u/s 140A	Date of furnishing return of income or payment of tax, whichever is later	Date of grant of refund	However, no interest shall be payable if the amount of refund due is less than 10% of the tax determined under section 143(1) or on regular assessment.
In any other case	Date of payment of tax or penalty	Date of grant of refund	NA

Note: For the purposes of this clause, "date of payment of tax or penalty" means the date on and from which the amount of tax or penalty specified in the notice of demand issued under section 156 is paid in excess of such demand.

- **Sub -Section (3)**

Where, as a result of an order under section 143(3) or section 144 or section 147 or section 154 or section 155 or section 250 or section 254 or section 260 or section 262 or section 263 or section 264 or an order of the Settlement Commission under section 245D(4), the amount on which interest was payable under sub-section 244A(1) has been increased or reduced, as the case may be, the interest shall be increased or reduced accordingly, and in a case where the interest is reduced, the Assessing Officer shall serve on the assessee a notice of demand in the prescribed form specifying the amount of the excess interest paid and requiring him to pay such amount; and such notice of demand shall be deemed to be a notice under section 156 and the provisions of this Act shall apply accordingly.

- **Sub- Section (1A)**

Additional interest on refund arising out of fresh assessment order giving effect to appellate or revisionary order:- Where a refund arises as a result of giving effect to an order under section 250/254/260/262/264, wholly or partly, otherwise than by making a fresh assessment or reassessment, the assessee shall be entitled to receive, in addition to the interest payable under section 244A(1), an additional interest on such refund amount calculated at the rate of 3% p.a., for the period beginning from the date following the date of expiry of the time allowed under section 153(5) to the date on which the refund is granted.

- **Sub - Section (1B)**

Where refund of any amount becomes due to the deductor in respect of any amount paid to the credit of the Central Government under Chapter XVII-B (TDS Provisions), such deductor shall be entitled to receive, in addition to the said amount, simple interest thereon calculated at the rate of one-half per cent for every month or part of a month comprised in the period, from the date on which—

(a) claim for refund is made in the prescribed form; or

(b) tax is paid, where refund arises on account of giving effect to an order under section 250 or section 254 or section 260 or section 262,
to the date on which the refund is granted.

- **Sub -Section (2)**

If the proceedings resulting in the refund are delayed for reasons attributable to the assessee or the deductor, as the case may be, whether wholly or in part, the period of the delay so attributable to him shall be excluded from the period for which interest is payable under sub-section (1) or (1A) or (1B), and where any question arises as to the period to be excluded, it shall be decided by the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner whose decision thereon shall be final.

51 - TAXATION OF MUTUAL CONCERNS**51.1 | CONCEPT OF MUTUALITY AND ITS TAXATION**

Observation of Calcutta High Court in case of General family Pension Fund Vs. Commissioner of Income Tax 14 ITR 488

- Mutual dealings arise out of a mutual association.
- To constitute a mutual association, a number of persons associate together to subscribe money for a fund for the purpose of it being spent upon a particular object, and the balance, if any, being returned to the subscribers and proportionately distributed amongst them. This balance is that part of the fund which is not absorbed by the particular object of the subscriptions. Those transactions are mutual dealings and the unrequired balance is the surplus.
- This surplus is not assessable to income-tax since it arises out of mutual dealings.

51.2 | INCORPORATION OF A COMPANY TO CARRY ON THE ACTIVITIES OF CLUB MAY NOT AFFECT THE CLAIM OF EXEMPTION ON GROUND OF MUTUALITY

The Supreme Court in CIT vs. vs. Royal Western India Turf Club Ltd. (1953) 24 ITR 551, 560 (SC) laid down the above principle

51.3 | CONCEPT OF MUTUALITY EXTENDS TO THE INCOME FALLING UNDER HEAD HOUSE PROPERTY

Supreme Court in CHELMSFORD CLUB vs. COMMISSIONER OF INCOME TAX 243 ITR 89 (SC) made the above observation.

51.4 | CONCEPT OF MUTUALITY FAILS FOR TAXING RENTAL INCOME WHEN MARRIAGE HALL LET OUT TO NON-MEMBERS

Kerala High Court in CIT V. Trivandrum Club 282 ITR 505 made following observation

Real contributors of income by availing of the facilities of the marriage hall are not the members but non-members. In order to enable them to avail of the facilities of the club, non-members are to be given temporary membership only for the purpose of availing of this benefit. Marriage hall was admittedly being rented out to nonmembers making them as temporary members only for the purpose of letting out the marriage hall and the amounts received from non-members are provided at the hands of the assessee. Principle of mutuality therefore, would not apply in such facts situation.

51.5 | TRANSFER FEES RECEIVED BY A CO-OPERATIVE HOUSING SOCIETY FROM ITS INCOMING AND OUTGOING MEMBERS - EXEMPT ON THE GROUND OF PRINCIPLE OF MUTUALITY

Bombay High Court in case of SIND CO-OPERATIVE HOUSING SOCIETY vs. INCOME TAX OFFICER 317 ITR 47 made following observation:

The transfer fee can be appropriated only if the transferee is admitted to membership. The fact that a proposed transferee may make payment in advance by itself is not relevant. The amount can only be appropriated on the

transferee being admitted as a member. As it is a transfer fee, if the transferee is not admitted as a member, the amount received will have to be refunded, as the amount is payable only on a transfer of rights of the transferor in the transferee.

Considering the bye-laws, the society is registered with the object principally of looking after the property including building thereon. There is no trading or business transactions. The members by adopting the bye-laws agree amongst themselves that a fee for transfer of flat / tenement when it is sold would be paid to the society. It may be that both incoming or outgoing members have to contribute to the common fund of the society. The amount paid however, is to be exclusively used for the benefits of the members as a class. There is no legal bar for the assessee to earn profits but the profit must come from a commercial activity in the nature of trade, business or the like in which event the assessee then will have to pay tax on such profits. Charging of transfer fees as per bye-laws has no element of trading or commerciality. Therefore, such transfer fee is not liable to tax.

51.6	CONCEPT OF MUTUALITY ENDS MOMENT THE CLUB DEPOSITS AMOUNT WITH ITS CORPORATE MEMBERS, BEING BANKS AND FINANCIAL INSTITUTIONS, WITH THE SOLE AIM OF EARNING INTEREST ON DEPOSITS.

The Andhra Pradesh High Court in case of **CIT v. Secunderabad Club Picket (2012) 340 ITR 121**, made the above observation.

51.7	EXPRESS PROVISION FOR TAXING MUTUAL CONCERNS

Section:- 2(24)

- (1) Section 2(24)(v) :** Income received by a trade or professional or similar association from specific services rendered to members.
- (2) Section 2(24)(vii) :** The profits and gains of any business of insurance carried on by a mutual insurance company or by a co-operative society, computed in accordance with section 44 or any surplus taken to be such profits and gains by virtue of provisions contained in the First Schedule.
- (3) Section 2(24)(viii) :** The profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members.

51.8	SPECIAL DEDUCTIONS IN CASE OF TRADE PROFESSIONAL OR SIMILAR ASSOCIATION

Section:- 44A

- (a)** As per the definition of income and the provisions of section 28, where the mutual concern is a trade, professional or similar association, the income derived from specific services performed for its members, is chargeable to tax.
- (b)** Therefore, surplus of such mutual concerns from other activities is not chargeable to tax.
- (c)** As per the various judicial pronouncements, if source is exempt from tax, then loss from this source cannot be set-off against any other taxable income.
- (d)** However, section 44A is an exception to the above rule. As per this section, if assessee is a trade, professional or similar association, then lowest of the following shall be allowed as deduction
 - loss from non-taxable activities
 - 50% of total income of such association before claiming deduction under this section.
- (e)** The benefit of deduction under this section is not available to the institutions or associations whose income is exempt under section 10 (23A).

Practical 1

Andhra Chamber of Commerce provides following information:

Particulars	Situation 1 (Rs.)	Situation 2 (Rs.)	Situation 3 (Rs.)
Income derived from providing specific services to members.	1,25,000	1,00,000	1,12,000
Surplus (Deficit) from other activities	75,000	(-) 1,40,000	(-) 30,000

Find out total Income.

Solution**Computation of Total Income of Andhra Chamber of Commerce.**

Particulars	Situation 1 (Rs.)	Situation 2 (Rs.)	Situation 3 (Rs.)
Income derived from providing specific services to members.	1,25,000	1,00,000	1,12,000
Less: Deduction under section 44A	NA	50,000	(-) 30,000
Total Income	1,25,000	50,000	82,000

Reader's Note:

52 – TAXATION OF SUBSIDIES/GRANTS

53 – MISCELLANEOUS

53.1	OBLIGATION TO FURNISH STATEMENT OF FINANCIAL TRANSACTION OR REPORTABLE ACCOUNT

Section:- 285BA

As per Section 285BA of the Income Tax Act, 1961 (as substituted by Finance Act, 2014 w.e.f 01-04-2015), specified entities (Filers) are required to furnish a statement of financial transaction or reportable account (hereinafter referred to as 'statement') in respect of specified financial transactions or any reportable account registered/recorded/maintained by them during the financial year to the income-tax authority or such other prescribed authority.

(1) Persons required to file statement of financial transaction or reportable account

Following persons shall be required to furnish statement of financial transactions or reportable accounts registered or recorded or maintained by them during a financial year to the prescribed authority:

- (a) an assessee;
- (b) the prescribed person in the case of an office of Government;
- (c) a local authority or other public body or association;
- (d) the Registrar or Sub-Registrar appointed under section 6 of the Registration Act, 1908(16 of 1908);
- (e) the registering authority empowered to register motor vehicles under Chapter IV of the Motor Vehicles Act, 1988 (59 of 1988);
- (f) the Post Master General as referred to in clause (j) of section 2 of the Indian Post Office Act, 1898 (6 of 1898);
- (g) the Collector referred to in clause (g) of section 3 of the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013 (30 of 2013);
- (h) the recognised stock exchange referred to in clause (f) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956);
- (i) an officer of the Reserve Bank of India, constituted under section 3 of the Reserve Bank of India Act, 1934 (2 of 1934);
- (j) a depository referred to in clause(e) of sub-section (1) of section 2 of the Depositories Act, 1996 (22 of 1996); or
- (k) a prescribed reporting financial institutions

(2) The periodicity and due date of furnishing statement of financial transaction or reportable account

The statement of financial transactions shall be furnished on or before the 31st May, immediately following the financial year in which the transaction is registered or recorded in Form 61A:

Provided the statement of financial transaction in respect of the transactions listed at serial number (12) and serial number (13) in the Table under sub-rule (2), shall be furnished on or before the 31st day of January, 2017 in Form 61A.

However, section 285BA(5) empower the tax authorities to issue a notice to the person who had not filed the statement within prescribed time. In such a case, the tax authorities may serve upon such person a notice requiring him to furnish the statement within a period not exceeding 30 days from the date of service of such notice and in such a case the person shall furnish the statement within the time as specified in the notice.

(3) Consequences of not furnishing statement of financial transaction or reportable account

Non-furnishing of statement of financial transaction or reportable account will attract penalty under section 271FA. Penalty can be levied of Rs. 100 per day of default.

However, section 285BA(5) (as discussed earlier) empower the tax authorities to issue a notice to the person directing him to file the statement within a period not exceeding 30 days from the date of service of such notice and in such a case person shall furnish the statement within the time specified in the notice.

If person fails to file the statement within the specified time, then a penalty of Rs. 500 per day will be levied from the day immediately following the day on which the time specified in such notice for furnishing the statement expires.

The penal provisions under section 271FA are summarized below –

Non-compliance of section	Penalty under section 271FA	Period
285BA(1)	Rs. ~~100~~ 500 per day of continuing default [w.e.f.A.Y.2019-20]	1st June immediately following the financial year in which the transaction is registered or recorded till the date of furnishing the AIR or the date of expiry of the time specified in the notice u/s 285BA(5), whichever is earlier.
285BA(5)	Rs. ~~500~~ 1000 per day of continuing default. [w.e.f.A.Y.2019-20]	The day immediately following the day on which the time specified in notice u/s 285BA(5) for furnishing the AIR expires till the date of furnishing of AIR.

(4) Inaccurate or defective statement of financial transaction or reportable account

If any person, after filing the statement, comes to know or discovers any inaccuracy in the information provided in the statement, he shall inform such inaccuracy to the prescribed income-tax authority within a period of ten days and furnish the correct information in such manner as may be prescribed.

On the other hand, the prescribed income-tax authority may also intimate the defect to the person and give him an opportunity of rectifying the defect within a period of thirty days from the date of such intimation or within such extended period as may be allowed by prescribed income-tax authority. However, if a person fails to rectify the defect within the said period than such statement shall be treated as an invalid statement and the provisions of this Act shall apply as if such person had failed to furnish the statement.

(5) Consequences of filing inaccurate or defective statement of financial transaction or reportable account

As per section 271FAA of the Income-tax Act, if a prescribed reporting financial institution referred to in Section 285BA(1)(k) who is required to furnish statement of financial transaction or reportable account, provides inaccurate information in the statement, and where:

- the inaccuracy is due to a failure to comply with the due diligence requirement prescribed under section 285BA(7) or is deliberate on the part of that person;
 - the person knows of the inaccuracy at the time of furnishing the statement but does not inform the prescribed income-tax authority or such other authority or agency;
 - the person discovers the inaccuracy after the statement is furnished and fails to inform and furnish correct information within a period of 10 days as specified under section 285BA(6),
- then, the prescribed income-tax authority may direct that such person shall pay, by way of penalty, a sum of fifty thousand rupees.

Notes:

- The Board may prescribe different values for different transactions in respect of different persons having regard to the nature of such transactions. However, the aggregate value of such transactions during a financial year shall not be less than Rs. 50,000.

(ii) Notification is as under:

Notification No. 95/2015, dated 30-12-2015

Furnishing of Statement of Financial Transaction [Rule 114E]

The statement of financial transaction required to be furnished under section 285BA(1) of the Income-tax Act, 1961 shall be furnished by every person mentioned in column (3) of the Table below in respect of all the transactions of the nature and value specified in the corresponding entry in column (2) of the said Table, which are registered and recorded by him on or after 1st April, 2016.

Sr. No.	Nature and value of transaction	Class of person (reporting person)
(1)	(a) Payment made in cash for purchase of bank drafts or pay orders or banker's cheque of an amount aggregating to Rs. 10 lakh or more in a financial year. (b) Payments made in cash aggregating to Rs. 10 lakh or more during the financial year for purchase of pre-paid instruments issued by Reserve Bank of India under the Payment and Settlement Systems Act, 2007. (c) Cash deposits or cash withdrawals (including through bearer's cheque) aggregating to Rs. 50 lakhs or more in a financial year, in or from one or more current account of a person	A banking company or a co-operative bank to which the Banking Regulation Act, 1949 applies (including any bank or banking institution referred to in section 51 of that Act)
(2)	Cash deposits aggregating to Rs. 10 lakhs or more in a financial year, in one or more accounts (other than a current account and time deposit) of a person.	(i) A banking company or a co-operative bank to which the Banking Regulation Act, 1949 applies (including any bank or banking institution referred to in section 51 of that Act); (ii) Post Master General as referred to in the Indian Post Office Act, 1898.
(3)	One or more time deposits (other than a time deposit made through renewal of another time deposit) of a person aggregating to Rs. 10 lakhs or more in a financial year of a person	(i) A banking company or a co-operative bank to which the Banking Regulation Act, 1949 applies (including any bank or banking institution referred to in section 51 of that Act); (ii) Post Master General as referred to in the Indian Post Office Act, 1898; (iii) Nidhi referred to in section 406 of the Companies Act, 2013; (iv) NBFC which holds a certificate of registration under section 45-IA of the Reserve Bank of India Act, 1934, to hold or accept deposit from public.
(4)	Payments made by any person of an amount aggregating to- (i) Rs. 1 lakh or more in cash; or (ii) Rs. 10 lakh or more by any other mode,	A banking company or a co-operative bank to which the Banking Regulation Act, 1949 applies (including any bank or banking institution referred to in section 51 of that Act)

	against bills raised in respect of one or more credit cards issued to that person, in a financial year.	Act) or any other company or institution issuing credit card.
(5)	Receipt from any person of an amount aggregating to Rs. 10 lakh or more in a financial year for acquiring bonds or debentures issued by the company or institution (other than the amount received on account of renewal of the bond or debenture issued by that company).	A company or institution issuing bonds or debentures.
(6)	Receipt from any person of an amount aggregating to Rs. 10 lakh or more in a financial year for acquiring shares (including share application money) issued by the company.	A company issuing shares
(7)	Buy back of shares from any person (other than the shares bought in the open market) for an amount or value aggregating to Rs. 10 lakh or more in a financial year	A company listed on a recognised stock exchange purchasing its own securities under section 68 of the Companies Act, 2013.
(8)	Receipt from any person of an amount aggregating to Rs. 10 lakh or more in a financial year for acquiring units of one or more schemes of a Mutual Fund (other than the amount received on account of transfer from one scheme to another scheme of that Mutual Fund).	A trustee of a Mutual Fund or such other person managing the affairs of the Mutual Fund as may be duly authorised by the trustee in this behalf.
(9)	Receipt from any person for sale of foreign currency including any credit of such currency to foreign exchange card or expense in such currency through a debit or credit card or through issue of travellers cheque or draft or any other instrument of an amount aggregating to Rs. 10 lakh or more during a financial year	Authorised person as referred to in section 2(c) of the Foreign Exchange Management Act, 1999
(10)	Purchase or sale by any person of immovable property for an amount of Rs. 30 lakhs or more or valued by the stamp valuation authority referred to in section 50C at Rs. 30 lakhs or more	Inspector-General appointed under the Registration Act, 1908 or Registrar or Sub-Registrar appointed under that Act
(11)	Receipt of cash payment exceeding Rs. 2 lakh for sale, by any person, of goods or services of any nature (other than those specified at Sl. Nos. 1 to 10 of this rule, if any).	Any person who is liable for audit under section 44AB of the Act
(12)	Cash deposits during the period 09 th November, 2016 to 30 th December, 2016 aggregating to— (i) twelve lakh fifty thousand rupees or more, in one or more current account of a person; or (ii) two lakh fifty thousand rupees or more, in one or more accounts (other than a current account) of a person.	(i) A banking company or a co-operative bank to which the Banking Regulation Act, 1949 (10 of 1949) applies (including any bank or banking institution referred to in section 51 of that Act); (ii) Post Master General as referred to in clause (j) of section 2 of the Indian Post Office Act, 1898 (6 of 1898).]

(13)	Cash deposits during the period 1 st of April, 2016 to 9 th November, 2016 in respect of accounts that are reportable under Sl.No.12.	(i) A banking company or a co-operative bank to which the Banking Regulation Act, 1949 (10 of 1949) applies (including any bank or banking institution referred to in section 51 of that Act); (ii) Post Master General as referred to in clause (j) of section 2 of the Indian Post Office Act, 1898 (6 of 1898).]

Manner of application of threshold limit:

The reporting person mentioned in column (3) of the Table under sub-rule (2) [other than the person at Sl.No.10 and Sl. No. 11] shall, while aggregating the amounts for determining the threshold amount for reporting in respect of any person as specified in column (2) of the said Table,-

- (a) take into account all the accounts of the same nature as specified in column (2) of the said Table maintained in respect of that person during the financial year;
- (b) aggregate all the transactions of the same nature as specified in column (2) of the said Table recorded in respect of that person during the financial year;
- (c) attribute the entire value of the transaction or the aggregated value of all the transactions to all the persons, in a case where the account is maintained or transaction is recorded in the name of more than one person;
- (d) apply the threshold limit separately to deposits and withdrawals in respect of transaction specified in item (c) under column (2), against Sl. No. 1 of the said Table.

Practical 1

A private bank has not filed its statement of financial transaction (SFT) in relation to the specified financial transactions for the financial year 2018-19. A notice was issued by the prescribed income-tax authority on 1st July, 2019 requiring the bank to furnish the return by 31st July, 2019. The bank, however, furnished the SFT only on 2nd September, 2019. What would be the penalty leviable u/s 271FA?

Solution

Non-compliance of section	Penalty under section 271FA	Period	Quantum of penalty under section 271FA	
(1)	(2)	(3)	(2) X (3)	(Rs.)
285BA(1)	Rs.500 per day of continuing default	1.06.2019 to 31.07.2019	61 days × Rs. 500	30,500
285BA(5)	Rs.1000 per day of continuing default	1.08.2019 to 02.09.2019	33 days × Rs. 1000	33,000
				63,500

Reader's Note:

54 – TAXATION OF NON-RESIDENT

UNIT A - BASIC CONCEPTS

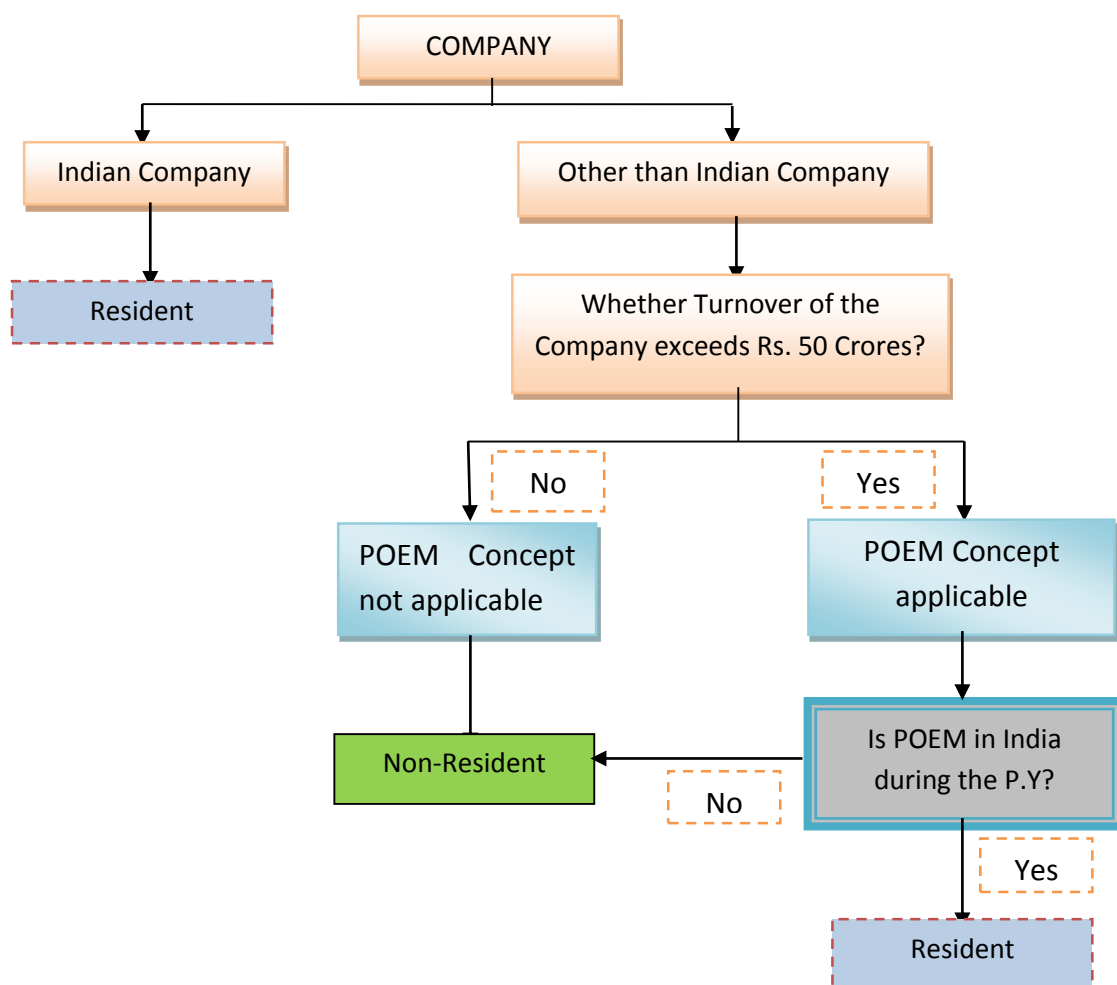
54.1 HOW TO DETERMINE RESIDENTIAL STATUS OF A COMPANY?

Section:- 6(3)

A company is said to 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.**

Explanation:- For the purposes of this clause "place of effective management" means 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.



GUIDING PRINCIPLES ON POEM

Circular No. 6/2017, dated 24.01.2017 & Circular No. 8/2017, dated 23-02-2017

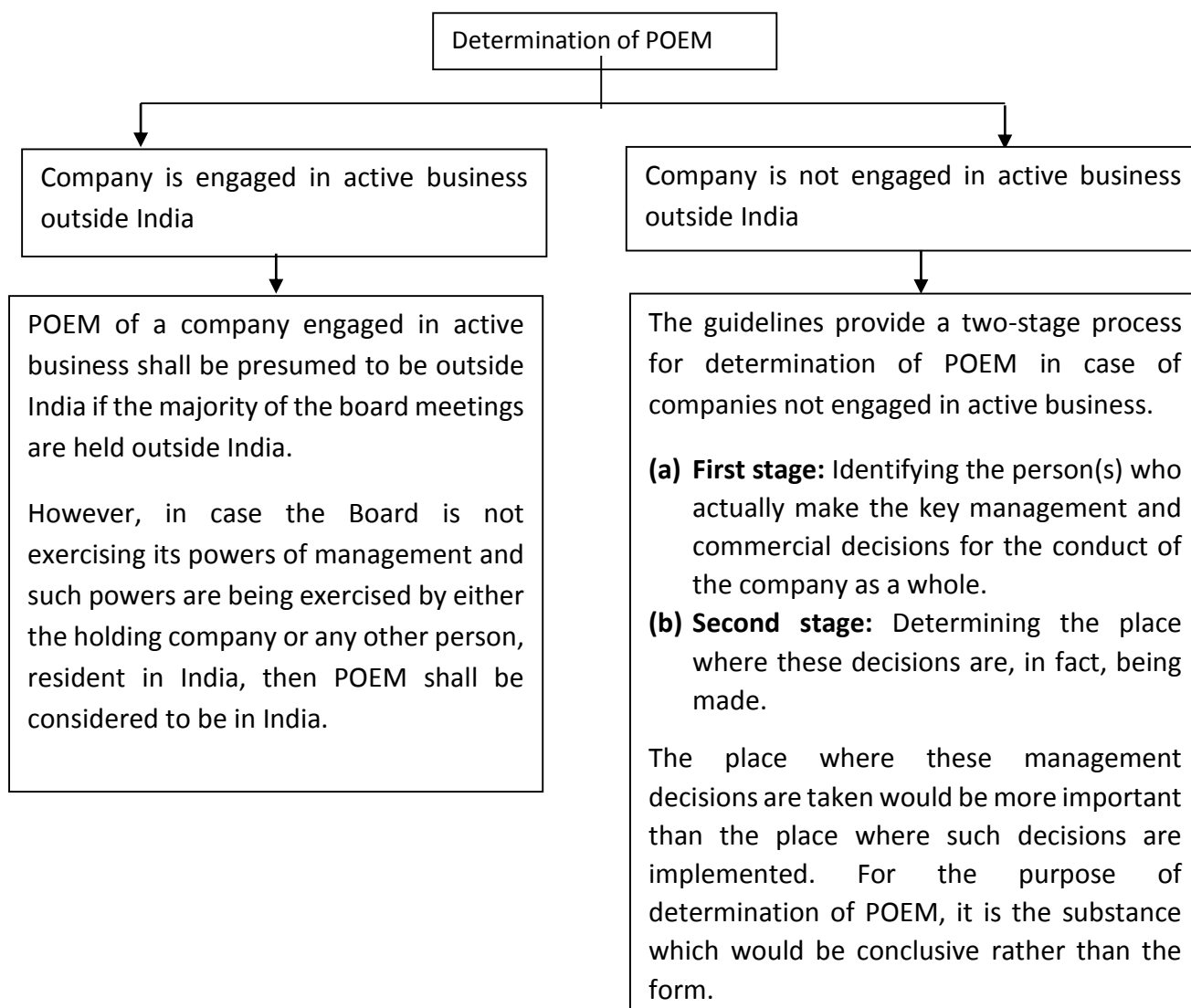
Fundamental Points to be noted.

- Any determination of the POEM will depend upon the facts and circumstances of a given case.
- The POEM concept is one of substance over form.

- An entity may have more than one place of management, but it can have only one place of effective management at any point of time.
- Since “residential status” is to be determined for each year, POEM will also be required to be determined on year to year basis.

Process of determination of POEM

The process of determination of POEM would be primarily based on the fact as to **whether or not the company is engaged in active business outside India**.



When company shall be said to be engaged in “active business outside India”?

A company shall be said to be engaged in “active business outside India”

- if the passive income is not more than 50% of its total income; **and**
- less than 50% of its total assets are situated in India; **and**
- less than 50% of total number of employees are situated in India or are resident in India; **and**
- the payroll expenses incurred on such employees is less than 50% of its total payroll expenditure.

For the purpose of determining whether the company is engaged in active business outside India, the average of the data of the previous year and two years prior to that shall be taken into account. In case the company has been in existence for a shorter period, then, data of such period shall be considered. Where the accounting year

for tax purposes, in accordance with laws of country of incorporation of the company, is different from the previous year, then, data of the accounting year that ends during the relevant previous year and two accounting years preceding it shall be considered.

Meaning of certain terms:

Term	Meaning									
Income	(a) As computed for tax purpose in accordance with the laws of the country of incorporation; or (b) As per books of account, where the laws of the country of incorporation does not require such a computation									
Value of assets	<table><tr><td>(a)</td><td>In case of an individually depreciable asset</td><td>The average of its value for tax purposes in the country of incorporation of the company at the beginning and at end of the previous year;</td></tr><tr><td>(b)</td><td>In case of pool of fixed asset, being treated as a block for depreciation</td><td>The average of its value for tax purposes in the country of incorporation of the company at the beginning and at end of the year;</td></tr><tr><td>(c)</td><td>In case of any other asset</td><td>Value as per books of account</td></tr></table>	(a)	In case of an individually depreciable asset	The average of its value for tax purposes in the country of incorporation of the company at the beginning and at end of the previous year;	(b)	In case of pool of fixed asset, being treated as a block for depreciation	The average of its value for tax purposes in the country of incorporation of the company at the beginning and at end of the year;	(c)	In case of any other asset	Value as per books of account
(a)	In case of an individually depreciable asset	The average of its value for tax purposes in the country of incorporation of the company at the beginning and at end of the previous year;								
(b)	In case of pool of fixed asset, being treated as a block for depreciation	The average of its value for tax purposes in the country of incorporation of the company at the beginning and at end of the year;								
(c)	In case of any other asset	Value as per books of account								
Number of employees	The average of the number of employees as at the beginning and at the end of the year. It shall include persons, who though not employed directly by the company, perform tasks similar to those performed by the employees.									
Pay roll	This term includes the cost of salaries, wages, bonus and all other employee compensation including related pension and social costs borne by the employer									
Passive income	It is the aggregate of, - (i) income from the transactions where both the purchase and sale of goods is from/to its associated enterprises; and (ii) income by way of royalty, dividend, capital gains, interest or rental income; However, any income by way of interest shall not be considered to be passive income in case of a company which is engaged in the business of banking or is a public financial institution, and its activities are regulated as such under the applicable laws of the country of incorporation.									

Examples on determination of POEM

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 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;
- (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 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 3: The facts are same as in Example 2 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 Rs. 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 Rs. 10 lakh and over past years also the same trend in respect of value contribution of contracts above Rs. 10 lakh is seen.

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 4: 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 Rs. 5 crore. The annual payroll expenditure in respect of MD, CEO and sales head is of Rs. 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 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.

List of some of the guiding principles which may be taken into account for determining the POEM for the companies not engaged in active business outside India

- (a) The location where a company's Board regularly meets and makes decisions
- (b) Location of Executive Committee, in case powers are delegated by the board may be the company's place of effective management
- (c) Location of head office
- (d) Use of modern technology
- (e) Decisions via circular resolution or round robin voting
- (f) Decisions made by Shareholders are not relevant factor in determination of POEM
- (g) Day to day routine operational decisions are not relevant for determination of POEM

List of secondary factors which may be taken into account for determining the POEM for the companies not engaged in active business outside India

If the above factors do not lead to clear identification of POEM then the final guidelines provide that following secondary factors may be considered:

- Place where main and substantial activity of the company is carried out; or
- Place where the accounting records of the company are kept.

Determination of POEM is to be based on all the relevant facts and not on the basis of isolated facts

It needs to be emphasized that the determination of POEM is to be based on all relevant facts related to the management and control of the company, and is not to be determined on the basis of isolated facts that by itself do not establish effective management, as illustrated by the following examples:

- (i) The fact that a foreign company is completely owned by an Indian company will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.
- (ii) The fact that there exists a Permanent Establishment of a foreign entity in India would itself not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.
- (iii) The fact that one or some of the Directors of a foreign company reside in India will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.
- (iv) The fact of, local management being situated in India in respect of activities carried out by a foreign company in India will not, by itself, be conclusive evidence that the conditions for establishing POEM have been satisfied.
- (v) The existence in India of support functions that are preparatory and auxiliary in character will not be conclusive evidence that the conditions for establishing POEM in India have been satisfied.

While determining POEM, “Snapshot” approach should not be adopted

It is reiterated that the above principles for determining the POEM are for guidance only. No single principle will be decisive in itself. The above principles are not to be seen with reference to any particular moment in time rather activities performed over a period of time, during the previous year, need to be considered.

In other words a “snapshot” approach is not to be adopted. Further, based on the facts and circumstances if it is determined that during the previous year the POEM is in India and also outside India then POEM shall be presumed to be in India if it has been mainly /predominantly in India.

Duty of the assessing officer to obtain prior approval of the Principal Commissioner or Commissioner before concluding that POEM of a particular company in India

The Assessing Officer (AO) shall, before initiating any proceedings for holding a company incorporated outside India, on the basis of its POEM, as being resident in India, seek prior approval of the Principal Commissioner or the Commissioner, as the case may be.

Further, in case the AO proposes to hold a company incorporated outside India, on the basis of its POEM, as being resident in India then any such finding shall be given by the AO after seeking prior approval of the collegium of three members consisting of the Principal Commissioners or the Commissioners, as the case may be, to be constituted by the Principal Chief Commissioner of the region concerned, in this regard. The collegium so constituted shall provide an opportunity of being heard to the company before issuing any directions in the matter.

Section 115JH:- Transition provision for foreign company said to be resident in India

- Where a foreign company becomes resident for the first time in India due to POEM criteria, then, the Central Government is empowered to notify that the provisions of this Act relating to the computation of total income, treatment of unabsorbed depreciation, set off or carry forward and set off of losses, collection and recovery and special provisions relating to avoidance of tax shall apply with such exceptions, modifications and adaptations as may be specified in that notification for the said previous year.
- However, the above modifications or adaptations shall be subject to such conditions as Central Government may notify in this behalf.
- These transition provisions would also cover any subsequent previous year upto the date of determination of POEM in an assessment proceedings. However, once the transition is complete, then normal provision of the Act would apply.
- Where, in a previous year, any benefit, exemption or relief has been claimed and granted to the foreign company in accordance with the notification issued under this section, and, subsequently, there is failure to comply with any of the conditions specified in the notification, then,—
 - (i) such benefit, exemption or relief shall be deemed to have been wrongly allowed;
 - (ii) the Assessing Officer may re-compute the total income of the assessee for the said previous year and make the necessary amendment as if the exceptions, modifications and adaptations did not apply; and
 - (iii) The above re-computation shall be made under section 154 within four years from the end of the previous year in which the failure to comply with the condition takes place.
- Every notification issued under this section shall be laid before each House of Parliament.

Practical 1

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, 2018** in compliance with RBI guidelines. It just 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.2019-20**.

Whether ABC Inc. is required to file any statement under Income Tax Act, 1961?

Solution

- 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 and support functions that are preparatory or auxiliary in nature are performed are not relevant in determining the place of effective management.
- Considering the amendment in section 6(3) of the Act, ABC Inc., being a foreign company is a non-resident for **A.Y.2019-20**, since its place of effective management is outside India in the **P.Y.2018-19**.
- **As per section 285 of the Act**, Every person, being a **non-resident having a liaison office in India** set up in accordance with the guidelines issued by the Reserve Bank of India under the Foreign Exchange Management Act, 1999, **shall**, in respect of its activities in a financial year, **prepare and deliver or cause to be delivered to the Assessing Officer** having jurisdiction, **within sixty days from the end of such financial year, a statement in such form and containing such particulars as may be prescribed**. [As per notification no. 5/2012 dated 6-2-2012, form no. 49C shall be submitted in electronic form]

Readers Note:

54.2 INCOME DEEMED TO ACCRUE OR ARISE IN INDIA**Section:- 9**

The following incomes shall be deemed to accrue or arise in India:

(1) Business connection

Income accruing or arising through or from any business connection in India is taxable irrespective of residential status of a person. Examples of business connection are:-

- Opening subsidiary company in India.
- Opening branch in India
- Appointing agent in India

Business connection includes Professional Connection also.

(2) House property or other source

Income through or from any property, any asset or source of income in India shall be deemed to accrue or arise in India.

(3) Capital Gain

Income through the transfer of a capital asset situated in India shall be deemed to accrue or arise in India.

(4) Salary [Section 9(1)(ii)]

Income which falls under the head 'Salaries' shall be deemed to accrue or arise in India if services are rendered in India. Further, salary for the rest period or leave period which is preceded and succeeded by services rendered in India and forms part of the service contract of employment shall also be deemed to accrue or arise in India.

Practical 2

Mr. James, non-resident, seafarer seeks your guidance on taxability of remuneration for services rendered outside India on a foreign going ship but credited in NRE (Non-Resident External) account maintained with an Indian Bank.

Solution

CBDT vide Circular No. 13/2017, dated 11-04-2017 and Circular No. 17/2017, dated 26-04-2017 clarified as under:

“Salary accrued to a non-resident seafarer for services rendered outside India on a foreign going ship (with Indian flag or foreign flag) shall not be included in the total income merely because the said salary has been credited in the NRE account maintained with an Indian bank by the seafarer.”

As a result, remuneration received by Mr. James, non-resident for services rendered outside India on a foreign going ship but credited in NRE (Non-Resident External) account maintained with an Indian Bank, shall not be taxable.

Readers Note:**(5) Salary paid by the Government to a citizen of India [Section 9(1)(iii)]**

Salary paid by the Government to a citizen of India for service outside India shall be deemed to accrue or arise in India. It may be noted that allowances and perquisites paid outside India by the Government is exempt by virtue of section 10(7).

Practical 3

Mr. Nayankumar, a citizen of India, employed in the Indian Embassy at Tokyo, Japan. He provides following information for the relevant previous year:-

Particulars	Amount (Rs.)
Basic Pay	1,50,000 p.m.
Dearness Allowance	15,000 p.m.
Transport Allowance	12,000 p.m.
Servant allowance	3,000 p.m.
Sumptuary allowance	5,000 p.m.
Rent Free official residence	3,00,000 (Annual License fee)
Bonus	75,000

Examine the taxability of salary, allowances and perquisites in the hands of Mr. Nayankumar assuming that his salary was received in Japan and he is non-resident for the relevant previous year

Solution**Computation of taxable salary of Mr. Nayankumar**

Particulars	Amount in (Rs.)	Amount in (Rs.)
Basic Pay	1,50,000 p.m. × 12 months	18,00,000
Dearness Allowance	15,000 p.m.	Exempt under section 10(7)
Transport Allowance	12,000 p.m.	Exempt under section 10(7)
Servant allowance	3,000 p.m.	Exempt under section 10(7)
Sumptuary allowance	5,000 p.m.	Exempt under section 10(7)
Rent Free official residence	3,00,000 (Annual License fee)	Exempt under section 10(7)
Bonus	75,000	75,000
Taxable Salary		18,75,000

Readers Note:

Practical 4

Mr. Joseph (not a citizen of India), an employee of American Government posted to India to assume the charge of American Embassy in India. Since services are rendered in India, salary income shall be deemed to accrue or arise in India, therefore, Mr. Joseph seeks your advice on taxability of remuneration in India.

Does your answer differ, if Mr. Joseph is a citizen of India?

Solution

As per the provisions of section 9, salary income earned by Mr. Joseph is deemed to accrue or arise in India and therefore, remuneration received by him shall be taxable in India.

However, **section 10(6)(ii)** may be at his help. As per the provision of this section, the remuneration received by him as an official, by whatever name called, of an embassy, high commission, legation, commission, consulate or the trade representation of a foreign State, or as a member of the staff of any of these officials, for service in such capacity is exempt. This exemption is subject to following conditions:

- (a) He is not a citizen of India and
- (b) the remuneration of the corresponding officials or member of the staff of Government of India enjoys a similar exemption in that country and
- (c) he is not engaged in any other business or profession or employment in India.

If Mr. Joseph is a citizen of India, then benefit of section 10(6)(ii) shall not be available and therefore remuneration earned by him in India shall be taxable.

Readers Note:**(6) Dividend paid by an Indian company [Section 9(1)(iv)]**

Dividend paid by an Indian company is always deemed to accrue or arise in India

(7) Interest [Section 9(1)(v)]

Interest are deemed to accrue or arise in India if payable by:-

Nature of Income	Payable by Government	Payable by Resident	Payable by Non Resident
Interest on monies borrowed	Deemed to accrue or arise in India	Deemed to accrue or arise in India if borrowed funds are used for :- (a) business or profession carried on in India or (b) for any source of income in India	Deemed to accrue or arise in India only when borrowed funds are used for the purposes of business or profession carried on in India.

(8) Royalty and fees for technical services

Royalty and fees for technical services are deemed to accrue or arise in India if payable by:-

Nature of Income	Payable by Government	Payable by Resident	Payable by Non Resident
Royalty / Fees for technical services	Deemed to accrue or arise in India	Deemed to accrue or arise in India if borrowed funds are used for:- (a) business or profession carried on in India or (b) for any source of income in India.	Deemed to accrue or arise in India only when used for (a) business or profession carried in India or (b) for any other source of income in India

UNIT B – SPECIAL PROVISIONS UNDER CHAPTER 'CAPITAL GAIN'

54.3 CERTAIN TRANSACTIONS NOT TREATED AS TRANSFER**Section:- 47****(1) Section 47(viia)**

Any transfer of a capital asset, being bonds or Global Depository Receipts referred to in section 115AC(1), made by a non-resident to another non-resident is not treated as transfer provided that transfer is made outside India.

(2) Section 47(viiaa)

Any transfer of a capital asset, being rupee denominated bond of an Indian company issued outside India, made by a non-resident to another non-resident is not treated as transfer provided that transfer is made outside India.

(3) Section 47(viiab) [Inserted by Finance Act, 2018 w.e.f. A.Y. 2019-20]

Any transfer of a capital asset, being—

- (a) bond or Global Depository Receipt referred to in sub-section (1) of section 115AC; or
- (b) rupee denominated bond of an Indian company; or
- (c) derivative,

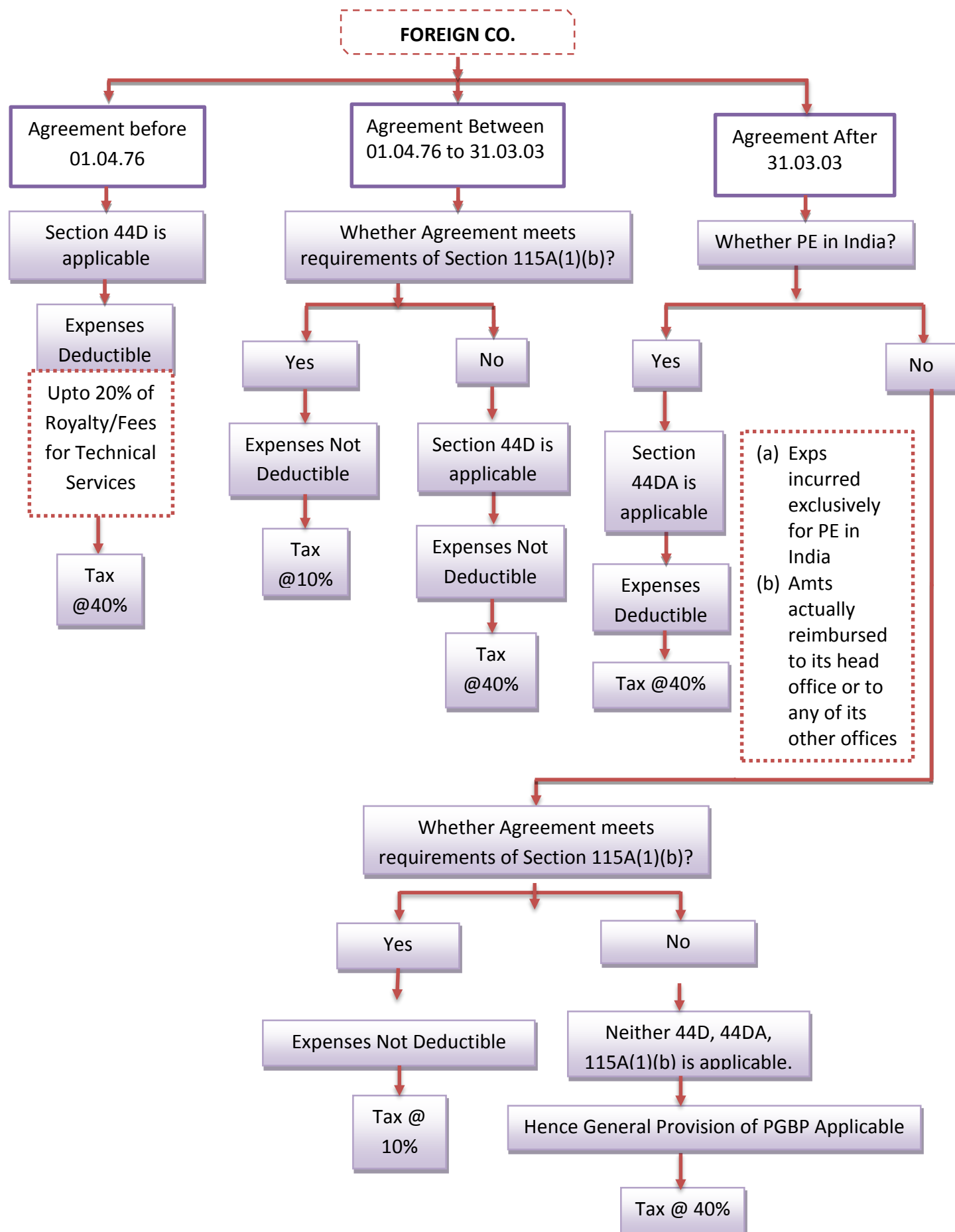
made by a non-resident on a recognised stock exchange located in any International Financial Services Centre and where the consideration for such transaction is paid or payable in foreign currency, is not treated as transfer.

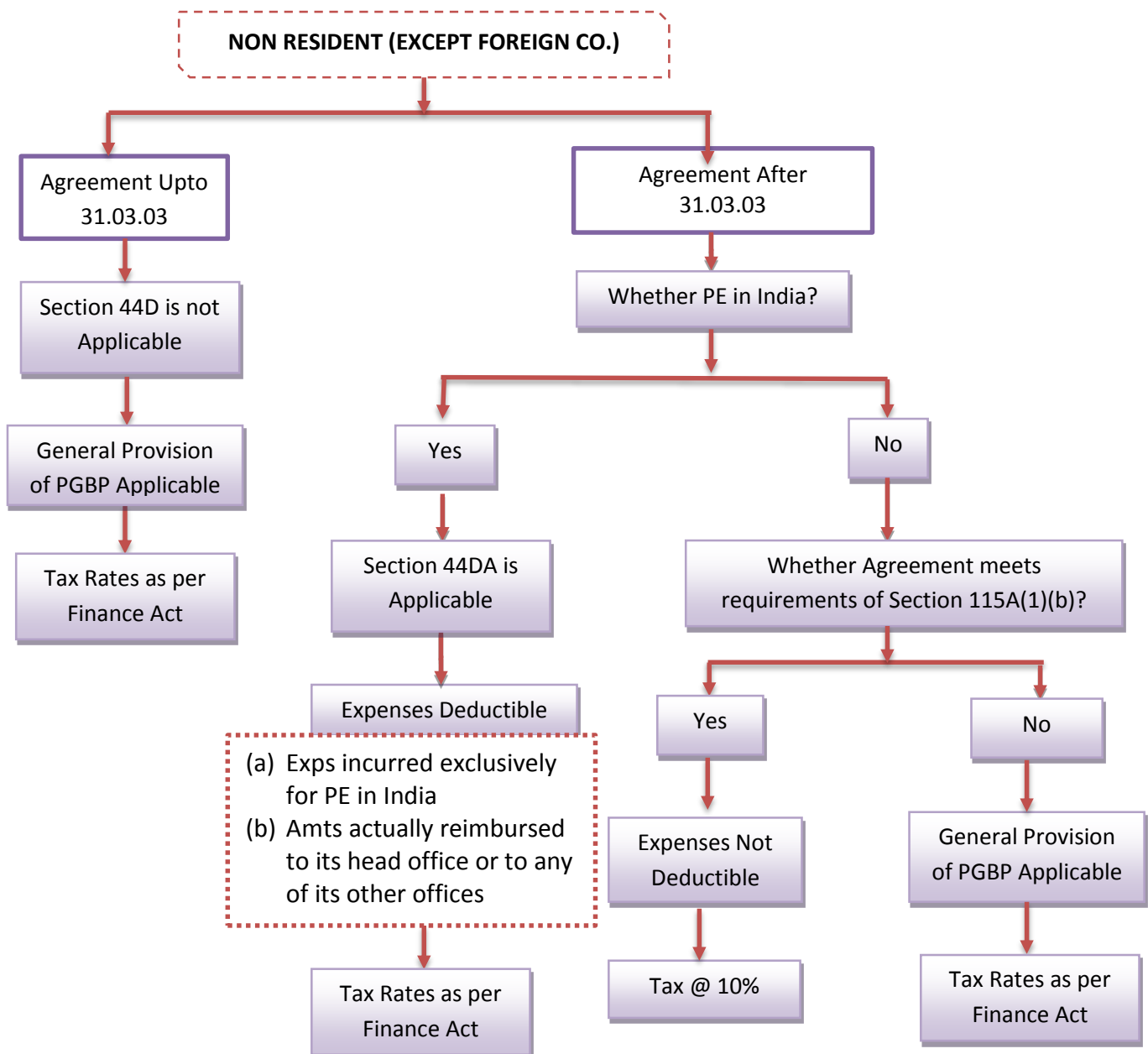
(4) Section 47(viib)

Any transfer of a capital asset, being a Government Security carrying a periodic payment of interest, made outside India by a non-resident to another non-resident is not treated as transfer if made through an intermediary dealing in settlement of securities.

UNIT C – SPECIAL PROVISIONS UNDER THE HEAD 'PGBP'

DIAGRAMMATICAL PRESENTATION SECTION 44D, 44DA & 115A(1)(b)





UNIT D – CHAPTER XII

54.4 CERTAIN TRANSACTIONS NOT TREATED AS TRANSFER

Section:- 47 – Modified by Finance Act, 2018 Effective from A.Y.2019-20

(1) Section 47(viia)

Any transfer of a capital asset, being bonds or Global Depository Receipts referred to in section 115AC(1), made by a non-resident to another non-resident is not treated as transfer provided that transfer is made outside India.

(2) Section 47(viiaa)

Any transfer of a capital asset, being rupee denominated bond of an Indian company issued outside India, made by a non-resident to another non-resident is not treated as transfer provided that transfer is made outside India.

(3) Section 47(viiab) [Inserted by Finance Act, 2018 w.e.f. A.Y. 2019-20]

Any transfer of a capital asset, being—

- (d) bond or Global Depository Receipt referred to in sub-section (1) of section 115AC; or
- (e) rupee denominated bond of an Indian company; or
- (f) derivative,

made by a non-resident on a recognised stock exchange located in any International Financial Services Centre and where the consideration for such transaction is paid or payable in foreign currency, is not treated as transfer.

(4) Section 47(viib)

Any transfer of a capital asset, being a Government Security carrying a periodic payment of interest, made outside India by a non-resident to another non-resident is not treated as transfer if made through an intermediary dealing in settlement of securities.

Practical 5

Mr. Raghu, a non-resident provides the following information:

- Information in respect of GDRs held in Indian companies:

Name of company	Nature of Capital Asset	Sale Consideration (Rs.)	Purchase Consideration (Rs.)	Remark:
A Ltd.	Long Term	8,30,000	7,25,000	Sold to another non-resident outside India.
B Ltd.	Long Term	12,50,000	10,00,000	--
C Ltd.	Long Term	\$82,000	\$77,500	Sold on a recognized stock exchange located in IFSC

Compute tax payable by Mr. Raghu.

54.5 CERTAIN TRANSACTIONS NOT TREATED AS TRANSFER

Section:- 115AD Modified by Finance Act, 2018 effective from A.Y. 2019-20

(a) Eligible Assessee: Foreign Institutional Investors (FIIs)

(b) Nature of Income and Tax Rate:

Sr. No.	NATURE OF INCOME	TAX RATE
1.	Long term capital gains on transfer of securities (other than units covered by section 115AB)	10%
2.	Income in respect of securities (<i>except covered by 115A</i>)	20%
3.	Any short-term capital gain on transfer of securities (except covered by section 111A)	30%
4.	Long term capital gains on transfer of capital asset referred to in section 112A of the Act exceeding Rs. 1 Lakh	10%

**SECTION 115AB**

- Section 115 AB provides that the long-term capital gain on transfer of units purchased in foreign currency shall be taxed at 10%

**SECTION 115A**

- Section 115A provides that interest accruing or arising to FII or QFI
- (a) on rupee denominated bond issued by the Indian company subject to provisions of section 194LD
 - (b) on Government Security
- shall be taxed at 5%.

Practical 6

SOL INC., a notified Foreign Institutional Investor (FII) derived the following incomes from various sources for financial year 2018-19:-

- (1) Income in respect of securities : Rs. 28,50,000
 Expenses incurred in respect thereof: Rs. 50,000
 (The above income includes an interest of Rs.16,00,000 received from an Indian Company on the investment of rupee denomination bonds and dividend income of Rs.3,50,000 from a domestic company referred to in section 115-O).
- (2) Capital Gains:
 - (i) Long Term:

Sale proceeds on sale of securities on 15.01.2019:	Rs.52,00,000
Purchase cost of securities on 25.05.2015:	Rs.28,00,000
Cost Inflation Index:	
2015-16: 254	
2018-19: 280	
 - (ii) Short Term:

Sale proceeds of equity shares of Company A (Jan., 19); [STT paid on Company A shares]	Rs.13,50,000
Cost of acquisition (Aug., 2018):	Rs.5,50,000
Sale proceeds of equity shares of Company B (Dec., 18)	Rs.9,25,000
Cost of acquisition (April 2018):	Rs.4,85,000
[STT not paid on Company B shares]	

Compute the taxable income of SOL Inc and tax liability for the assessment year 2019-20. Ignore MAT.

UNIT E – CHAPTER XII A**54.6 CHAPTER XIIA - SPECIAL PROVISIONS APPLICABLE TO NON-RESIDENTS INDIANS****Section:- 115C to 115I**

- (1) **Income covered by Chapter XII A and special tax rates [Section 115E]**
 1. Income arising from "Foreign Exchange Asset" (to be called income from investment) - Taxed @ 20 %
 2. Long term capital gains arising on transfer of foreign exchange asset – Taxed @ 10%
- (2) **Definitions [Section 115C]**
 - (a) "Foreign exchange asset" means the following assets acquired or purchased with or subscribed to in, convertible foreign exchange :
 - (i) Shares in an Indian company ;
 - (ii) Debentures issued by an Indian public company;

- (iii) Deposits with an Indian public company;
- (iv) Securities of the Central Government; and
- (v) Such other assets as may be notified by the Central Government.

(b) "Non-resident Indian" means an individual, being a citizen of India or a person of Indian origin who is not a resident.

A person shall be deemed to be of Indian origin if he, or either of his parents or any of his grandparents, was born in undivided India.

(3) How to compute income covered by section 115 E? [Section 115D]

(a) In computing investment income,

- No deduction in respect of any expenditure or allowance under any provisions of the Income-tax Act shall be allowed.
- No deduction under chapter VIA shall be allowed.

(b) While computing capital gain,

- First proviso to section 48 (Conversion Rule) is applicable and therefore benefit of Indexation is not available.
- No deduction under chapter VIA shall be allowed.

(4) Exemption for long term capital gains [Section 115F]

The long term capital gains arising from the transfer of any foreign exchange asset will be exempt as per following formula provided net proceeds realised on such transfer are re-invested or re-deposited within 6 months from the date of such transfer in the "Foreign exchange assets" or savings certificates notified u/s.10 (4B).

$$\frac{\text{Amount invested}}{\text{Net consideration}} \times \text{Long Term Capital Gain}$$

However, where the new asset is transferred or converted (otherwise than by transfer) into money within a period of three years from its acquisition, the capital gains arising from the transfer of the original asset which has been exempted from tax shall be deemed to be the long term capital gains of the previous year in which the new asset is transferred or converted into money.

(5) Return of income [Section 115G]

A non-resident Indian having only investment income or income by way of long-term capital gains arising from the transfer of any foreign exchange asset or both, need not file his return of income u/s. 139, if the tax deductible from such income has been correctly deducted at source.

(6) Benefit after the assessee becomes resident [Section 115H]

A non-resident Indian who becomes a resident in any subsequent year has the option to claim that the special provisions shall continue to apply to him in relation to investment income derived from foreign exchange asset for that assessment year and for every subsequent assessment year until the transfer or conversion of such assets into money.

Such option can be exercised by furnishing a declaration in writing to the Assessing Officer to that effect along with his return of income for that assessment year.

(7) Option to Assessee [Section 115 I]

A non-resident Indian has the option to claim that in respect of any particular assessment year the special provisions relating to chapter XII A should not apply to him by furnishing his return of income with such declaration for that assessment year u/s. 139. In such a case, the whole of the total income of that assessment year will be charged to tax under the general provisions of the Income-tax Act.

Practical 7

Ajay, a non-resident Indian, has the following sources of income in India during the previous year **2018-19**:

Sr. No.	Particulars	Rs.	Rs.
(i)	Income from house property located in India (computed)		1,80,000
(ii)	Dividend from Indian Companies		75,000
(iii)	Interest on debentures of Indian company (Subscribed in convertible foreign exchange)	1,00,000	
	Less: Interest on loan taken for purchase of debentures	20,000	80,000
(iv)	Long-term capital gains on sale of debentures subscribed in US \$:		
	Cost in 2004-05	4,00,000	
	Sale in 2018-19	6,00,000	
		2,00,000	
	Less: Commission to brokers	(6,000)	1,94,000
	Cost Inflation Index: F.Y. 2004-05 - 113; F.Y.2018-19 – 280.		

Compute the tax payable by Ajay for **A.Y 2019-20**, if he opts for the provisions of Chapter XII-A of the Income-tax Act, 1961.

Solution**Computation of tax liability of Mr. Ajay for the A.Y. 2019-20 as per Chapter XII-A**

Particulars	Rs.	Rs.
Tax on long term capital gain (Rs. 1,94,000 × 10% as per chap. XIIA)	19,400	
Tax on interest on debentures being investment income (Rs.1,00,000 × 20% as per chap. XIIA)	20,000	
Tax on balance income of Rs. 1,80,000	Nil	39,400
Add: Health and Education cess @ 4%		1,576
Total tax liability		40,976
Total tax liability (rounded off)		40,980

Notes:

(1) Computation of total income of Mr. Ajay for the A.Y. 2019-20 as per provisions of Chapter XII-A

Particulars	Rs.	Rs.
Income from house property (computed)		1,80,000
Capital Gains on sale of debentures		
Sale consideration	6,00,000	
Less: Commission to brokers	(6,000)	
Net consideration	5,94,000	
Less: Cost of acquisition (Refer Note 2)	(4,00,000)	
Long term capital gain		1,94,000
Dividend income received from Indian companies [exempt u/s 10(34)]		Nil
Interest on debentures of Indian company (Refer Note 3)		1,00,000
Total Income		4,74,000

(2) It has been assumed that the debentures referred to in the question are issued by an Indian company which is not a private company and are hence, specified assets. Since the specified assets have been subscribed in convertible foreign exchange, they are foreign exchange assets.

If a non-resident purchases shares in, or debentures of, an Indian company by utilising foreign currency, capital gain shall be calculated under first proviso to section 48 in the same foreign currency which was initially utilised in purchase of shares and debentures. Capital gains so computed in foreign currency shall

be reconverted into Indian currency. Since the telegraphic transfer buying rates and telegraphic transfer selling rates of US \$ on the date of acquisition, date of sale and 31st March, 2019 are not given in the question, effect has not been given to the first proviso to section 48 in the above solution.

As per section 115D, the indexation benefit would not be available for calculating cost of acquisition for computing long term capital gains under Chapter XII-A.

- (3) No expenditure is allowed to be deducted from the interest on debentures being the investment income as per the provisions of section 115D. Therefore, interest on loan taken for purchase of debentures is not deductible.

Readers Note:

UNIT F – EXEMPTION IN CASE OF NON-RESIDENTS

UNIT G – SECTION 9

54.7 MEANING OF BUSINESS CONNECTION

Section:- Explanation 2 to section 9(1) (i) modified while Explanation 2A inserted w.e.f. A.Y. 2019-20.

Business connection as defined by Supreme Court in case of CIT vs. R.D. Aggarwal & Co.[1965]56 ITR 20

The expression "business connection" undoubtedly means something more than "business". A business connection involves a relation between a business carried on by a non-resident which yields profits or gains and some activity in the taxable territories which contributes directly or indirectly to the earning of those profits or gains.

Business connection as defined in Explanation 2 to section 9(1)(i)

As per Explanation 2 to section 9(1) (i), "business connection" shall include any business activity carried out through a person who, acting on behalf of the non-resident,—

~~(a) who has and who habitually exercises in India, an authority to conclude contracts on behalf of the non-resident, unless his activities are limited to the purchase of goods or merchandise for the non-resident; or~~

Following clause (a) shall be substituted for the existing clause (a) of Explanation 2 to clause (i) of sub-section (1) of section 9 by the Finance Act, 2018, w.e.f. A.Y. 2019-20:

(a) has and habitually exercises in India, an authority to conclude contracts on behalf of the non-resident or habitually concludes contracts or habitually plays the principal role leading to conclusion of contracts by that non-resident and the contracts are—

(ii) in the name of the non-resident; or

(iii) for the transfer of the ownership of, or for the granting of the right to use, property owned by that non-resident or that non-resident has the right to use; or

(iv) for the provision of services by the non-resident; or

[This amendment in the definition of "business connection" is for the purpose of alignment with the provisions of the Double Taxation Avoidance Agreement (DTAA) as modified by Multilateral Instrument (MLI) so as to make the provisions in the treaty effective.]

(b) who has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident; or

(c) habitually secures orders in India, mainly or wholly for the non-resident.

Further, there may be situations when the person acting on behalf of the non-resident secure order for other non-residents. In such situation, business connection for other non-residents is established if,

(i) such other non-resident controls the non-resident or

- (ii) such other non-resident is controlled by the non-resident or
- (iii) such other non-resident is subject to same control as that of non-resident

In all the three situations, business connection is established, where a person habitually secures orders in India, mainly or wholly for such non-residents.

Provided that such business connection shall not include any business activity carried out through a broker, general commission agent or any other agent having an independent status, if such broker, general commission agent or any other agent having an independent status is acting in the ordinary course of his business:

Provided further that where such broker, general commission agent or any other agent works mainly or wholly on behalf of a non-resident (referred to as the principal non-resident) or on behalf of such non-resident and other non-residents which are controlled by the principal non-resident or have a controlling interest in the principal non-resident or are subject to the same common control as the principal non-resident, he shall not be deemed to be a broker, general commission agent or an agent of an independent status.

Explanation 3

Where a business is carried on in India through a person referred to in clause (a) or clause (b) or clause (c) of *Explanation 2*, only so much of income as is attributable to the operations carried out in India shall be deemed to accrue or arise in India.

Practical 8

Examine in the context of provisions contained under the Income-tax Act, 1961 whether there exists business connection in India so as to bring the income earned, if any to tax net in India:-

- (i) Mr. Rajesh, a resident in India and based at Delhi is appointed as an agent by PQR Inc. a company incorporated in UK for tracking the Indian markets. He was canvassing the orders and then communicating to PQR Inc. in UK. He had no authority to accept the orders. All the orders were directly received, accepted and after receipt of the price/value, the delivery of goods was given by PQR Inc. outside India. No purchase of raw material or manufacturing of finished goods took place in India. The agent is entitled to receive the commission on the sales so concluded by PQR Inc.
- (ii) What would have been your answer in sr. no. (i) above, if Mr. Rajesh habitually plays principle role leading to conclusion of contract entered into by PQR Inc.?

Following Explanation 2A shall be inserted after Explanation 2 to clause (i) of sub-section (1) of section 9 by the Finance Act, 2018, w.e.f. A.Y. 2019-20:

Explanation 2A.—For the removal of doubts, it is hereby clarified that the significant economic presence of a non-resident in India shall constitute "business connection" in India and "significant economic presence" for this purpose, shall mean—

- (a) transaction in respect of any goods, services or property carried out by a non-resident in India including provision of download of data or software in India, if the aggregate of payments arising from such transaction or transactions during the previous year exceeds such amount as may be prescribed; or
- (b) systematic and continuous soliciting of business activities or engaging in interaction with such number of users as may be prescribed, in India through digital means:

Provided that the transactions or activities shall constitute significant economic presence in India, whether or not,—

- (i) the agreement for such transactions or activities is entered in India; or
- (ii) the non-resident has a residence or place of business in India; or
- (iii) the non-resident renders services in India:

Provided further that only so much of income as is attributable to the transactions or activities referred to in clause (a) or clause (b) shall be deemed to accrue or arise in India.

[This explanation has been inserted to take care of new business models such as digitized businesses, which do not require physical presence of itself or any agent in India. Such businesses can now be covered within the scope of section 9(1)(i).]

Practical 9

MEGA Mart Inc., a non-resident, regularly sells goods to its Indian Customers. It does not have any PE/Agent in India. Nor does it have any other physical presence in India. It would like to know the impact of the amendment carried out by Finance Act, 2018 more particularly when the goods dealt by it are not in a digitized form / software.

Explanation 1 to section 9(1)(i) provides that for the purpose of this clause-

- (a)** in the case of a non-resident, no income shall be deemed to accrue or arise in India to him through or from operations which are confined to the purchase of goods in India for the purpose of export ;
- (b)** in the case of a non-resident, being a person engaged in the business of running a news agency or of publishing newspapers, magazines or journals, no income shall be deemed to accrue or arise in India to him through or from activities which are confined to the collection of news and views in India for transmission out of India ;
- (c)** in the case of a non-resident, being—
 - (1) an individual who is not a citizen of India ; or
 - (2) a firm which does not have any partner who is a citizen of India or who is resident in India ; or
 - (3) a company which does not have any shareholder who is a citizen of India or who is resident in India,
 no income shall be deemed to accrue or arise in India to such individual, firm or company through or from operations which are confined to the shooting of any cinematograph film in India
- (d)** in the case of a business of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India
- (e)** in the case of a foreign company engaged in the business of mining of diamonds, no income shall be deemed to accrue or arise in India to it through or from the activities which are confined to the display of uncut and unassorted diamond in any special zone notified by the Central Government in the Official Gazette in this behalf.

UNIT H – FOREIGN COMPANY AND MINIMUM ALTERNATE TAX (MAT)

54.8 | APPLICABILITY OF MAT PROVISIONS TO FOREIGN COMPANIES

Section:- 115JB

Practical 10

Whether the provisions of MAT are applicable to foreign companies or not?

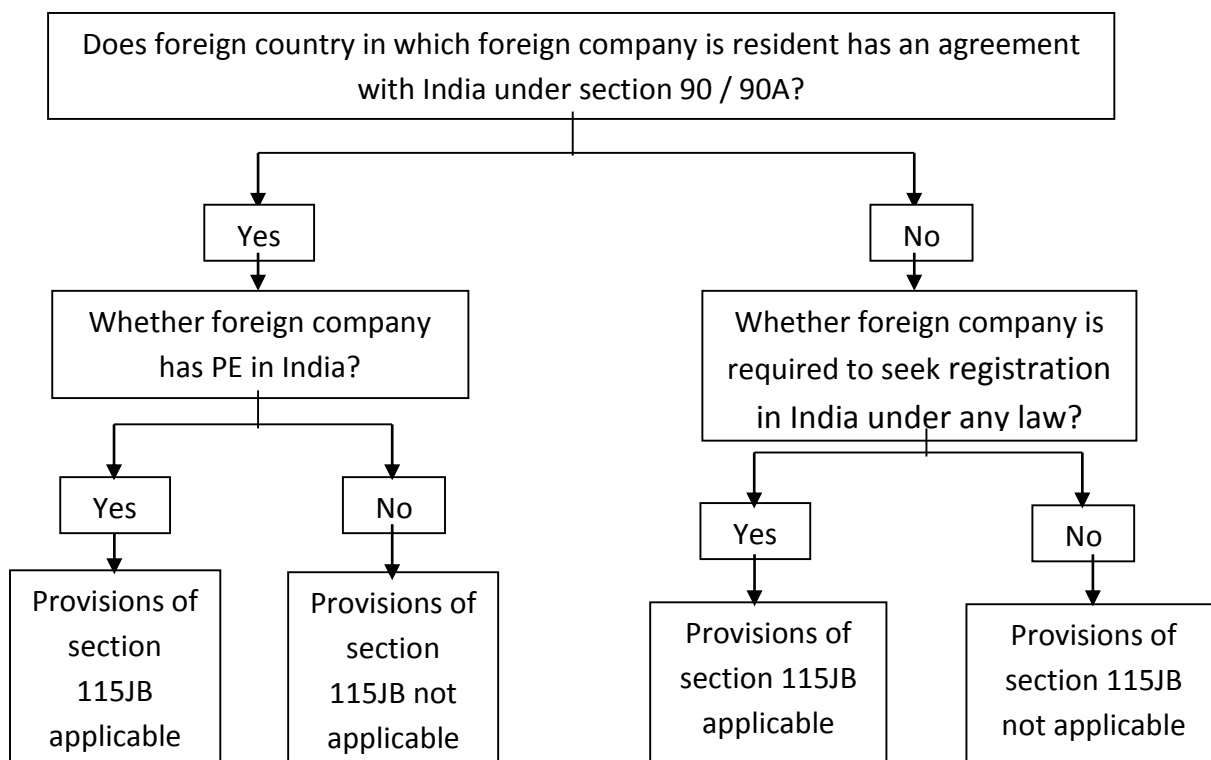
Solution

Amendment by Finance Act, 2016: with retrospective effect from A.Y. 2001-02

Provisions of section 115JB shall not be applicable to a foreign company if-

- (a) The assessee is a resident of a foreign country or specified territory with which India has an agreement under section 90/90A and the assessee does not have a permanent establishment in India in accordance with the provisions of such agreement or
- (b) The assessee is a resident of a foreign country or specified territory with which India does not have an agreement under section 90/90A and the assessee is not required to seek registration in India under any law for the time being in force relating to companies.

To sum up,



Readers Note:

Practical 11

Singapore Airlines Inc (SAI), a foreign company derives its income solely from the operations of aircrafts in India. It seeks your advice on applicability of MAT.

Does your answer differ, if SAI also provides technical services to Indian Airlines for maintenance of aircrafts in addition to the above activity?

Solution

Income derived from the operations of aircrafts falls under section 44BBA of the Act. If it is the only income derived by (SAI) during the previous year, then MAT provisions (section 115JB) are not applicable in view of the **retrospective amendment made by Finance Act, 2018 w.e.f. A.Y. 2001-02** which reads as under: -

Explanation 4A to section 115 JB(2)—*"For the removal of doubts, it is hereby clarified that the provisions of this section shall not be applicable and shall be deemed never to have been applicable to an assessee, being a foreign company, where its total income comprises solely of profits and gains from business referred to in section 44B or section 44BB or section 44BBA or section 44BBB and such income has been offered to tax at the rates specified in those sections.*

However, SAI is subject to MAT provisions if it derives any other income in addition to the operation of aircrafts in India.

Readers Note:

54.9 | SPECIAL ADJUSTMENTS TO ARRIVE AT BOOK PROFIT IN THE HANDS OF FOREIGN COMPANY**Section:- 115JB(2)****Positive Adjustment –**

Profit as shown in statement of profit and loss is to be increased by the following amounts if debited to the statement of profit and loss:

- the amount or amounts of expenditure relatable to income accruing or arising to an assessee, being a foreign company, from,—
 - (A) the capital gains arising on transactions in securities; or
 - (B) the interest, royalty or fees for technical services chargeable to tax at the rate or rates specified in Chapter XII,
 if the income-tax payable thereon in accordance with the provisions of this Act (other than the provisions governing MAT) is less than 18.5%.

Negative Adjustment–

Profit as shown in the statement of profit and loss is to be reduced by the following amounts:

- the amount of income accruing or arising to assessee, being a foreign company, from,—
 - (A) the capital gains arising on transactions in securities; or
 - (B) the interest, royalty or fees for technical services chargeable to tax at the rate or rates specified in Chapter XII,
 if the income-tax payable thereon in accordance with the provisions of this Act (other than the provisions governing MAT) is less than 18.5%.

Practical 12

Arnold Ltd. (incorporated in UK) has a branch office (PE) in India. The Net Profit of the Branch as per the statement of profit and loss for the year ended **31.03.2019** was Rs.83 lakhs. It includes the following:

- (i) Dividend from Indian companies (listed) Rs. 8,00,000.
- (ii) Dividend from Indian companies (unlisted) Rs. 4,00,000.
- (iii) Interest received from MMS Ltd. of Mumbai Rs. 7,00,000. The amount was received by the Indian company MMS Ltd. in foreign currency as per loan agreement dated **01.04.2014** (section 194LC applicable).
- (iv) Fee for technical services received from Barun Co. Ltd., Kolkata Rs. 25,00,000. The agreement was made on **10.08.2007** and was approved by Central Government. Expenditure incurred for providing technical service amounts to Rs. 6,00,000.

Additional information:

Total income chargeable to tax as per regular provisions of the Income-tax Act, 1961 (Act) is Rs.20,00,000 (without considering the items (i) to (iv) above).

You are required to compute the book profit tax under section 115JB of the Act for the assessment year **2019-20** and also the total income-tax liability of the assessee.

Your working should be supported by notes. Ignore DTAA with UK.

Solution**Step 1: Computation of “Book Profit”**

Particulars	Rs.	Rs.
Net Profit as per Statement of Profit and Loss		83,00,000
Less: Net profit to be decreased by the following amounts as per Explanation 1 to section 115JB:		

- Dividend income from listed and unlisted Indian companies, credited to statement of profit and loss [Dividend income from listed and unlisted Indian companies is exempt u/s 10(34) read with section 115BBDA to the extent of Rs.10 lakhs, in the hands of a foreign company. To this extent it can be reduced from net profit to arrive at book profit]	10,00,000	
- Interest income received from an Indian company as per loan agreement dated 1.4.2014, where the loan is given in foreign currency [Since income by way of interest chargeable to tax@5% under section 115A, being a rate lower than 18.5%, has been credited to statement of profit and loss, the same has to be reduced to arrive at book profit]	7,00,000	
- Fees for technical services under an agreement approved by the Central Government [No adjustment is required since the foreign company carries on business through a permanent establishment i.e., a branch in India. Such income, being effectively connected with the branch in India, is taxable@40% under section 44DA. Since the income is not taxable at a rate less than 18.5% it should not be reduced for determining book profit]	Nil	17,00,000
Book Profit		66,00,000

Step 2: Computation of MAY Liability

Particulars	Rs.
MAT @18.5% of Book Profit (Rs. 66,00,000)	12,21,000
Add: Health & Education Cess: (4%)	48,840
MAT Liability	12,69,840

Step 3. Computation of Total Income

Sr. No.	Particulars	Rs.	Rs.
(1)	Total Income [Before adjustment of (i) to (iv) adjustments of additional information]		20,00,000
	Income from Other sources		
	(i) Dividend Income from Indian Companies [Listed]	8,00,000	
	(ii) Dividend Income from Indian Companies [Unlisted]	4,00,000	
		12,00,000	
	Less: Exemption under section 10(34)	10,00,000	2,00,000
	(iii) Interest of received from MMS Ltd. as per loan agreement dated 1.4.2014, the loan being given in foreign currency		7,00,000
	(iv) Fees for technical services	25,00,000	
	Less: Expenditure incurred for providing technical service (deductible due to provisions of Section 44DA)	6,00,000	19,00,000
	Total Income		48,00,000

Step 4. Computation of Regular Tax Liability

Particulars	Section Applicable	Income (Rs.)	Tax Rate	Tax Liability
Dividend from Indian Companies	Section 115BBDA	2,00,000	10%	20,000
Interest of received from MMS Ltd.	Section 115A	7,00,000	5%	35,000
Fees for technical services	Finance Act	19,00,000	40%	7,60,000
Other Business Income	Finance Act	20,00,000	40%	8,00,000
Sub-total				16,15,000
Add: Health & Education Cess@4%				64,600
Tax Liability				16,79,600

Step 5. Tax Liability shall be higher of the step 2 or step 4

Particulars	Rs.
MAT Liability as per Step 2	12,69,840
Regular Tax Liability as per Step 4	16,79,600
Regular Tax Liability	16,79,600

Readers Note:

55 – DOUBLE TAXATION RELIEF

55.1 WHERE THERE IS AGREEMENT WITH FOREIGN COUNTRIES [BILATERAL RELIEF]

Section:- 90

(1) **Section 90(1)**

The Central Government may enter into an agreement with the Government of any country outside India to provide

(a) for grant of double taxation relief, for avoidance of double taxation by way of following methods:

- i. Exemption method: - Under this method, the relief is provided to the assessee by taxing a particular income in only one of the two countries, which would otherwise have been taxed in both the countries.
- ii. Tax credit method: - Under this method, the income of the assessee is taxable in both countries in accordance with their respective tax laws/DTAAs. However, the country of which the tax payer is a resident, allows him credit for the tax charged on the doubly taxed income in the other country.

(b) for exchange of information for the prevention of evasion or avoidance of Income Tax;

(c) for recovery of income-tax.

Explanation 1.—For the removal of doubts, it is hereby declared 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.

Explanation 4 has been inserted by the Finance Act, 2017, w.e.f. A.Y. 2018-19:

For the removal of doubts, it is hereby declared that where any term used in an agreement entered into under sub-section (1) is defined under the said agreement, the said term shall have the same meaning as assigned to it in the agreement; and where the term is not defined in the said agreement, but defined in the Act, it shall have the same meaning as assigned to it in the Act and explanation, if any, given to it by the Central Government.

(2) **Section 90(2)**

Where the Central Government has entered into DTAA with the Government of any country outside India or specified territory outside India, then, in relation to the assessee to whom such agreement applies, **the provisions of this Act shall apply to the extent they are more beneficial to that assessee.**

(3) **Section 90(4)**

An assessee, not being a resident, to whom DTAA applies, shall not be entitled to claim any relief under such agreement unless a **certificate of his being a resident in any country outside India or specified territory outside India**, as the case may be, is obtained by him from the Government of that country or specified territory.

(4) **Section 90(5)**

The assessee referred to in sub-section (4) shall also provide such other documents and information, as may be prescribed. (see notification given below)

- **Notification No. 39/2012 dated 17.09.2012**

Tax Residence Certificate – Form & Contents prescribed

The Central Board of Direct Taxes has, through this notification, inserted **new Rule 21AB** which shall come into force on 1.4.2013. The said Rule provides that the Certificate for claiming relief by a non-resident under an agreement referred to in sections 90 and 90A should contain the following particulars in form no. 10F :

- (i) Name of the assessee;
- (ii) Status (individual, company, firm etc.) of the assessee;
- (iii) Nationality (in case of individual);
- (iv) Country or specified territory of incorporation or registration (in case of others);
- (v) Assessee's tax identification number in the country or specified territory of residence or 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;
- (vi) Residential status for the purposes of tax;
- (vii) Period for which the certificate is applicable; and
- (viii) Address of the applicant for the period for which the certificate is applicable;

Such certificate should be duly verified by the Government of the country or the specified territory of which the person claims to be a resident for the purposes of tax.

In addition, the CBDT has also prescribed the form for an assessee, who is a resident in India, to make an application to the Assessing Officer for obtaining a certificate of residence for the purposes of an agreement referred to in section 90 and 90A. It has also prescribed the form in which the Assessing Officer, on receipt of such an application by the assessee and on being satisfied in this regard, shall issue a certificate of residence to such an assessee.

Note:- The **submission of TRC containing prescribed particulars shall be a necessary but not sufficient condition for availing benefits of the agreements** referred to in these sections. In effect, further conditions can be stipulated for claiming treaty benefits, in addition to the requirement of submission of TRC.

Practical 1

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? Discuss.

Solution

- 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 prescribed information (as discussed in above notification) Form No. 10F.
- 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.

Readers Note:**Practical 2**

Arif is a resident of both India and another foreign country in the previous year **2018-19**. He owns immovable properties (including residential house) in both the countries. He earned income of Rs. 50 lacs from rubber estates in the foreign country during the financial year **2018-19**. He also sold some house property situated in foreign country resulting in short-term capital gain of Rs. 10 lacs during the year. Arif has no permanent establishment of business in India. However, he has derived rental income of Rs. 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 state 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.

Solution

- 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 country. Thus, he has a permanent home in both the countries. However, he has no permanent establishment of business in India. The Double Taxation 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 with 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. 2019-20**.
- 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 a case, 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 **A.Y. 2019-20** 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.

Readers Note:

Question 3

The concept of Permanent Establishment is one of the most important concepts in determining the tax implications of cross border transactions. Explain 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.

That means, if permanent establishment is in other country, then income attributed to that PE shall be taxed in that source country.

As per section 92F(iia), the term “Permanent Establishment” includes a fixed place of business through which the business of an enterprise is wholly or partly carried on.

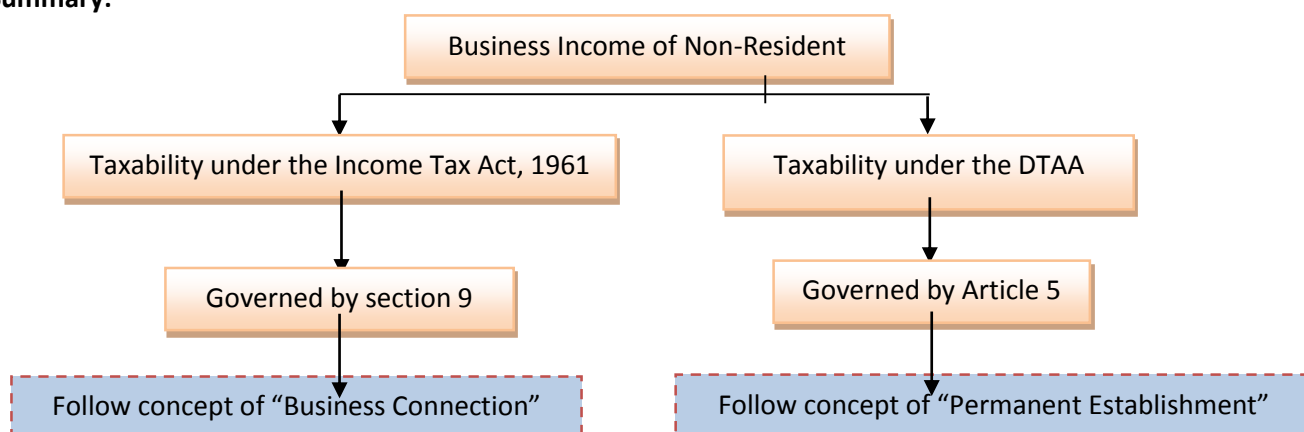
Section 9(1)(i) requires existence of business connection for deeming business income to accrue or arise in India.

DTAAs however provide that business income is taxable only if there is a permanent establishment in India.

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.

Summary:



Readers Note:

55.2 COUNTRIES WITH WHICH NO AGREEMENT EXISTS [UNILATERAL RELIEF]

Section:- 91

Unilateral relief under section 91 will be available, if the following conditions are satisfied:

- 1) The assessee in question must be resident in India.
- 2) That some income must have accrued or arisen to him outside India.

- 3) In respect of that income, the assessee must have paid by deduction or otherwise tax under the law in force in the foreign country in question in which the income outside India has arisen.
- 4) There shall be no reciprocal arrangement for relief or avoidance from double taxation with the said country.

If all the above conditions are satisfied, such person shall be entitled to deduction from the Indian income-tax payable by him of a sum calculated on such doubly taxed income at the Indian rate of tax or the rate of tax of the said (other) country, whichever is the lower or at the Indian rate of tax if both the rates are equal.

Indian rate of tax means the tax payable on total income divided by the total income.

Rate of tax of other country means income tax and super tax actually paid in that country in accordance with the corresponding laws in force in that country after deduction of all relief due, divided by the whole amount of income as assessed in that country.

As per section 91(2) the unilateral relief is also available in respect of agricultural income in Pakistan on which income-tax is levied in India and income-tax is levied in Pakistan on such agricultural income.

Judicial Rulings

Unilateral Relief under this section is available only in respect of doubly taxed income i.e. that part of income which is included in the total income of assessee. [CIT vs. Dr. R.N. Jhanji 185 ITR 586 (Raj)]

Average foreign tax rate shall be worked out for each foreign country separately and not on aggregate basis, if more than one foreign country's income is involved. [CIT vs. Bombay Burmah Trading Corporation Ltd. 259 ITR 423 (Bom.)]

Practical 4

Mr. Kamesh, 45 years, resident in India furnishes you the following particulars of income earned in India, Country "X" and Country "Y" for the previous year **2018-19**. India has not entered into double taxation avoidance agreement with these two countries.

Particulars	Rs.
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
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% & 25%, respectively. Royalty earned from Country "X" has been brought into India in convertible foreign exchange within a period of 6 months from the end of the previous year. Compute total income & tax payable by Mr. Kamesh in India for **A.Y. 2019-20**.

Solution

Computation of total income of Mr. Kamesh for A.Y.2019-20

Particulars	Rs.	Rs.
Income from House Property [House situated in country Y]		
Gross Annual Value	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	
Income from House Property [A]		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	65,000	
Profits and Gains of Business or Profession [B]		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 Rs. 50,000)	5,50,000	
Income from Other Sources [C]		7,50,000
Gross Total Income [A + B + C]		15,96,000
Less: Deduction under Chapter VIA		
Under section 80QQB – Royalty income of a resident from literary work		3,00,000
Total Income		12,96,000

Computation of tax liability of Mr. Kamesh for A.Y.2019-20

Particulars	Rs.
Tax on total income [30% of Rs. 2,96,000 + Rs.1,12,000]	2,01,300
Health and Education cess @ 4%	8,052
	2,09,352
Less: Rebate under section 91 (See Working Note below)	69,729
Tax Payable	1,39,623
Tax payable (rounded off)	1,39,620

Working Note: Calculation of Rebate under section 91

Particulars	Rs.	Rs.
Average rate of tax in India [i.e., Rs. 2,09,352 / Rs. 12,96,000 x 100]	16.15%	
Average rate of tax in country X	10%	
Doubly taxed income pertaining to country X		
Agricultural Income	50,000	
Royalty Income [Rs. 6,00,000 – Rs. 50,000 (Expenses) – Rs. 3,00,000 (deduction under section 80QQB)]	2,50,000	
	3,00,000	
Rebate under section 91 on Rs. 3,00,000 @10% [being the lower of average Indian tax rate (16.15%) 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 Rs. 2,46,000 @16.154% (being the lower of average Indian tax rate (16.15%) and foreign tax rate (25%))

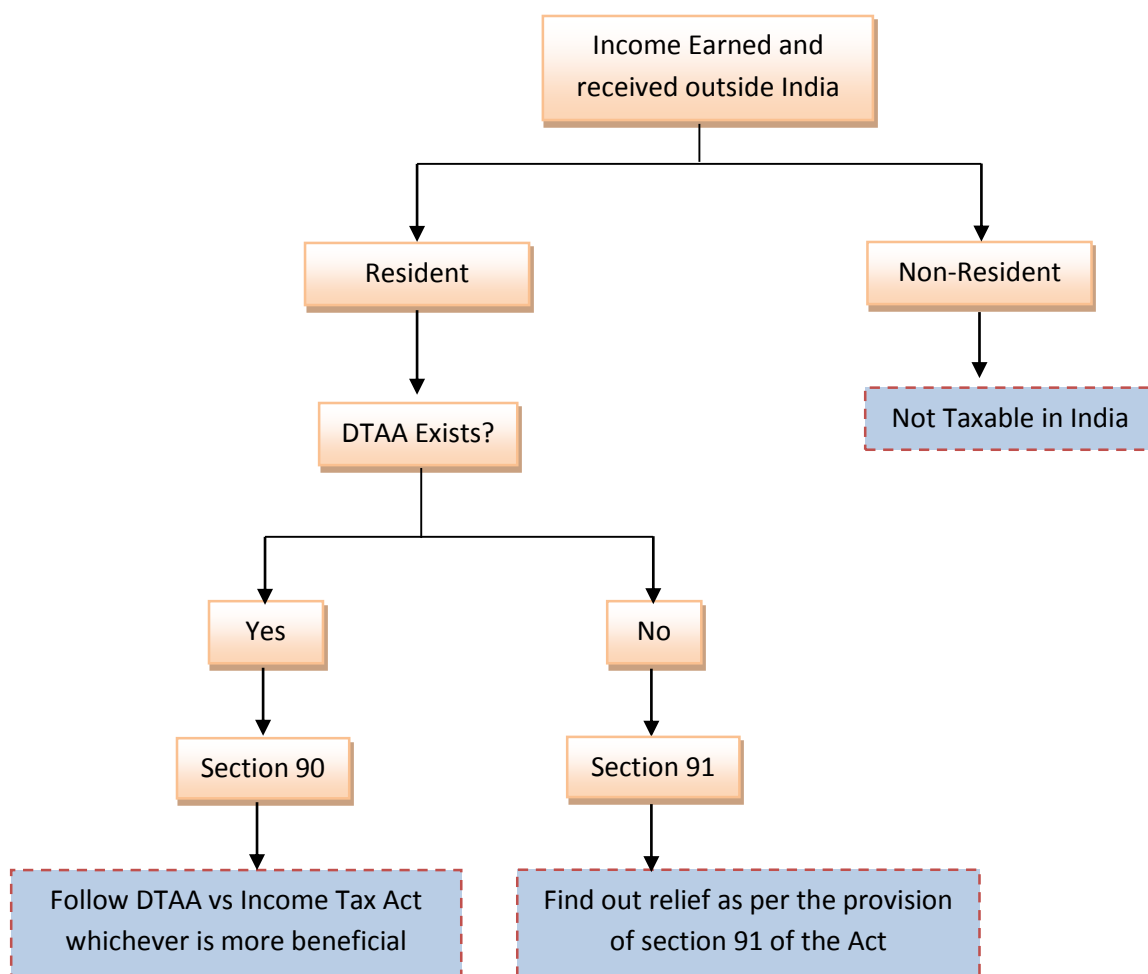
39,729

Total rebate under section 91 (Country X + Country Y)

69,729

Notes:

- (1) Rental Income has been taken as GAV in the absence of other information relating to fair rent, municipal value etc.
- (2) Doubly taxed income includes only that part of income which is included in the assessee's total income.– CIT v. Dr. R.N. Jhanji (1990) 185 ITR 586 (Raj.).
- (3) Average foreign tax rate shall be worked out for each foreign country separately and not on aggregate basis, if more than one foreign country's income is involved. [CIT vs. Bombay Burmah Trading Corporation Ltd. 259 ITR 423 (Bom.)]

Readers Note:**Summary – Taxability of income earned and received outside India**

56 – ADVANCE RULINGS

Refer Chapter 31

57 – TRANSFER PRICING AND OTHER ANTI-AVOIDANCE MEASURES**UNIT A – INTERNATIONAL TRANSACTIONS****57.1 OBJECTIVE OF INTRODUCING CHAPTER-X:- KNOWN AS: “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.
- As a result, Government set up an Expert Group to examine the issues relating to transfer pricing. As an outcome, 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.
- With effect from assessment year 2013-14, section 92BA has been inserted to extend applicability of transfer pricing to specified domestic transactions also.

57.2 CONDITIONS FOR APPLICABILITY OF ARM'S LENGTH PRICE IN THE INTERNATIONAL TRANSACTION**Section:- 92A, 92B and 92F (iii)****(1) Condition 1: There must be two or more enterprise.****Meaning of Enterprise [Section 92F(iii)]**

Enterprise means a person(including permanent establishment) who engages or has been engaged or proposed to engage in the following activities:

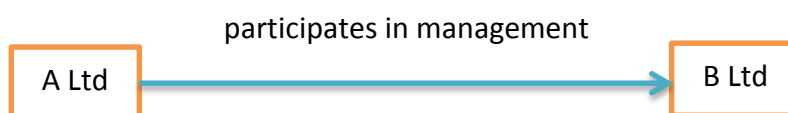
- (a) Any activity relating to the production, storage, supply, distribution, acquisition or control of articles or goods:
- (b) Know-how, patents, copyrights, trade-marks, licenses, franchises or any other business or commercial rights of similar nature or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights:
- (c) Any activity relating to the provision of services of any kind:
- (d) Carrying out any work in pursuance of a contract (e.g. construction contract).
- (e) Investment activity:
- (f) Activity relating to provision of loan
- (g) Business of acquiring, holding, underwriting or dealing with shares, debenture or other securities of any body corporate.

A person would be an enterprise irrespective of the fact that it carries on the abovementioned activity or business directly or through one or more of its units or divisions or subsidiaries.

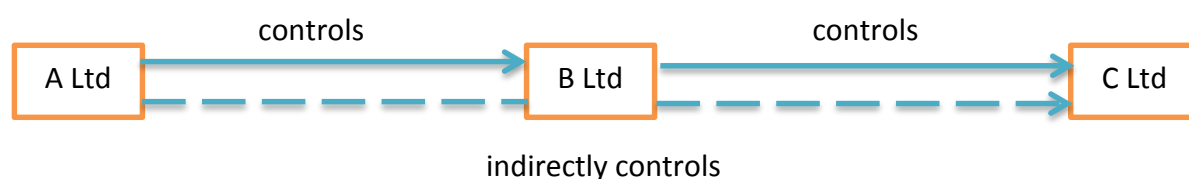
(2) Condition 2: Enterprises must be an Associated Enterprises [Section 92A]

- One enterprise would be regarded an associated enterprise of another, if-
 - a. it participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or

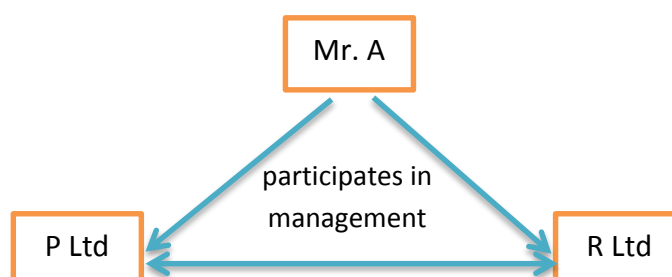
Example of "Direct Participation"



Example of "Indirect Participation"



- b. in respect of it one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.



- **Deemed Associated Enterprises**

For the purpose of this section, two enterprises shall be deemed to be associated enterprises if, at any time during the previous year:-

(i) Voting power criteria

One enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in the other enterprise.

E.g.: PQR INC. holds 26% voting power in ABC Private Ltd., then PQR INC. and ABC Private Ltd. are deemed to be associated enterprise.

(ii) Voting power by common person criteria

Any person or enterprise holds, directly or indirectly, shares carrying not less than twenty-six percent of the voting power in each of such enterprises.

E.g.: Mr. A holds 26% of shareholding in both Kharate Software Private Ltd. and Milan Softech INC., then Kharate Software and Milan Softech INC. are deemed to be associated enterprise.

(iii) Loan criteria

A loan advanced by one enterprise to the other enterprise constitutes not less than fifty-one percent of the book value of the total assets of the other enterprise.

E.g.: Book value of total assets of Indian Company is Rs.100 crores. The loan given by Foreign Company to such Indian Company is Rs. 55 crores, then Indian Company and Foreign Company are deemed to be associated enterprise.

(iv) Guarantor criteria

One enterprise guarantees not less than ten percent of the total borrowings of the other enterprise.

E.g.: Indian company raised borrowing from various Banks. Total borrowing raised by the Indian company was Rs. 50 crores, of which Rs. 12 crore (from SBI) was guaranteed by Foreign Company, then Indian Company and Foreign Company are deemed to be associated enterprise.

(v) Appointment in board of directors by other enterprise

More than half of the board of directors or members of the governing board, or one or more of the executive directors or executive members of the governing board of one enterprise, are appointed by the other enterprise.

E.g.: Foreign Company has seven directors on its Board. Out of that, Indian company has appointed 4 directors. In such case, Foreign Company and Indian Company are deemed to be associated enterprise.

(vi) Appointment in board of directors of two different enterprises by common person

More than half of the board of directors or members of the governing board, or one or more of the executive directors or members of the governing board, of each of the two enterprises are appointed by the same person or persons.

E.g. Mr. A appointed 4 directors out of 7 directors of ABC Ltd. and appointed one executive director on the board of PQR Ltd. In such case, ABC Ltd. and PQR Ltd. are deemed to be associated enterprise since a common person i.e. Mr. A appointed more than half of the directors in ABC Ltd. and appointed one executive director in PQR Ltd.

(vii) Dependence on Intangibles

The manufacture or processing of goods or articles or business carried out by one enterprise is wholly dependent on the use of know-how, patents, copyrights, trade-marks, licences, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights.

(viii) Dependence on raw material supply in manufacturing process

Ninety percent or more of the raw materials and consumables required for the manufacture or processing of goods or articles carried out by one enterprise, are supplied by the other enterprise, or by persons specified by the other enterprise, and the prices and other conditions relating to the supply are influenced by such other enterprise.

There are two situations dealt with in this clause and they are as follows:

90% or more of the raw materials and consumables required for manufacturing or processing of goods or articles carried out by one enterprise (say enterprise, A) are supplied

- (i) by the other enterprise (say enterprise B),
 - (ii) by the person (say enterprise C) specified by the enterprise B,
- and**

the prices and other conditions relating to supply are influenced by the enterprise B, then enterprise A and enterprise B shall be deemed to be the associated enterprise.

(ix) Dependence on sale

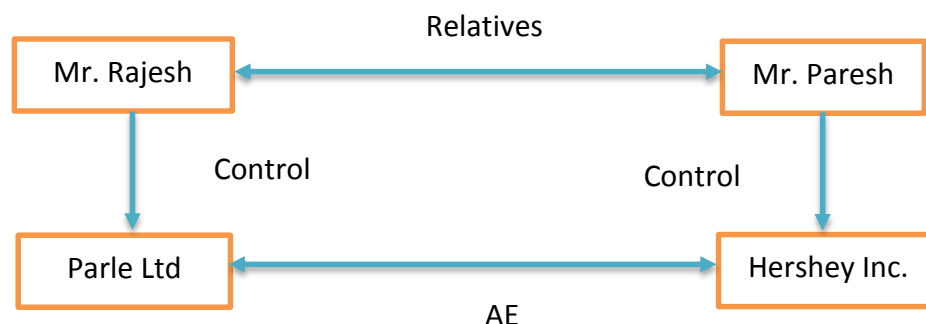
The goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise and the prices and other conditions relating thereto are influenced by such other enterprise.

While in clause (viii), a minimum criteria of 90% has been mentioned, no such quantification has been done in clause (ix). This clause covers only sale of goods manufactured or processed and not the sale of traded goods.

(x) Individual Control:

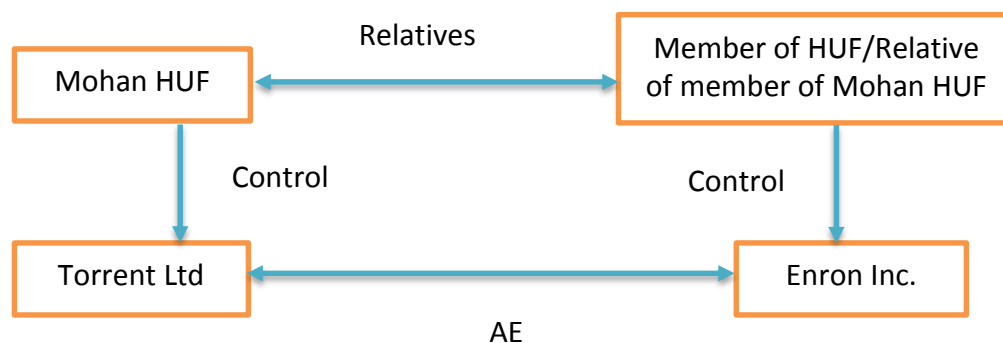
Where one enterprise is controlled by an individual, the other enterprise is also controlled by such individual or his relative or jointly by such individual and relative of such individual.

E.g. Mr. Rajesh has 36% voting power in Parle Ltd. while his brother Mr. Paresh has 40% voting power in Hershey Inc. Then, Parle Ltd. and Hershey Inc. shall be deemed to be associated enterprise.



(xi) Control by Hindu Undivided Family (HUF)

Where one enterprise is controlled by a Hindu undivided family, the other enterprise is controlled by a member of such Hindu undivided family, or by a relative of a member of such Hindu undivided family, or jointly by such member and his relative.



(xii) Holding in a firm, association of persons or body of individuals

where one enterprise is a firm, association of persons or body of individuals the other enterprise holds not less than ten percent interest in such firm, association of persons or body of individuals.

(xiii) Mutual interest relationship

There exists between the two enterprises, any relationship of mutual interest, as may be prescribed.

(3) Condition 3: International Transaction should be carried out by the Associated Enterprises [Section 92B]

- Meaning of International Transaction**

An international transaction means following transaction(s) between two or more associated enterprises where, either or both of whom are non-residents:-

1. A transaction in nature of (a) purchase, sale or lease of intangible property or (b) provision of services or (c) lending or borrowing money.
2. A transaction having a bearing on the profits, income, losses or assets of such associated enterprises.
3. A transaction having mutual agreement or arrangement between two or more associated enterprises for (a) allocation or appointment of, or (b) contributing to, any cost or expense incurred (or to be incurred) regarding a benefit, service or facility provided (or to be provided) to any one or more of such associated enterprise.

- Deemed International Transaction**

Section 92B(2) provides that a transaction entered into by an enterprise with a person other than an associated enterprise shall, for the purposes of sub-section (1), be deemed to be a transaction entered into between two associated enterprises subject to fulfilment of certain conditions. Refer following practical for detailed understanding of “Deemed international transaction”.

Practical 1

On 10/06/2016, A Ltd., a resident entity has entered into an agreement for sale of goods with PQR Ltd., another resident entity but unrelated to A Ltd.

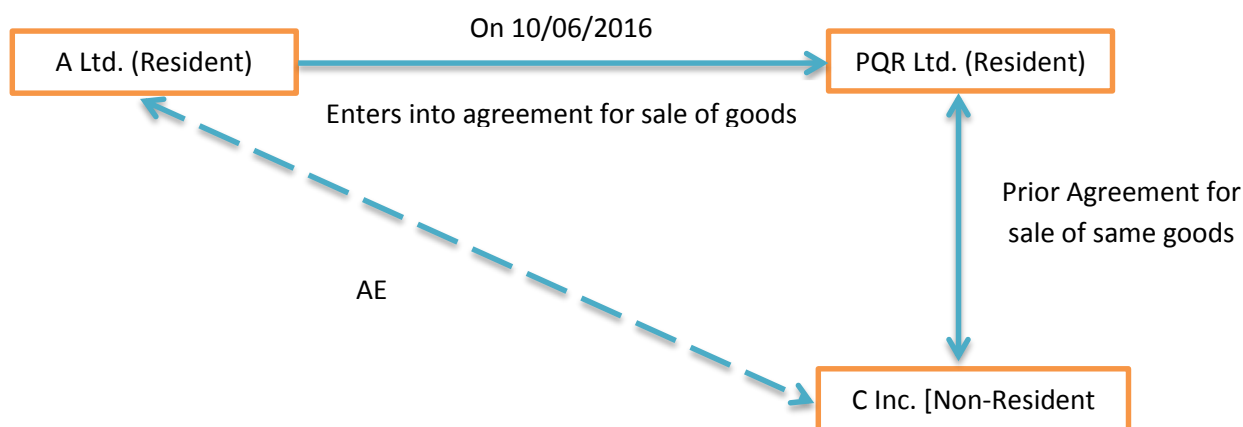
PQR Ltd. had already entered into an agreement (prior agreement) for the sale of same goods to C Inc. (unrelated to PQR Ltd.), a non-resident entity.

For the purpose of chapter “Transfer Pricing”, C Inc. and A Ltd. are associated enterprises.

A Ltd. claims that provisions of “transfer pricing” shall not be applicable to it because of following grounds:

- A Ltd. and PQR Ltd. are not associated enterprises
- Since A Ltd. and PQR Ltd. both are residents therefore transaction entered into by them is not an international transaction.

Verify the contention of A Ltd.

Solution

On close reading of section 92B(2), a transaction (**i.e. sale of goods**) entered into by an enterprise (**i.e. by A Ltd.**) with a person other than an associated enterprise (**i.e. with PQR Ltd.**) shall be deemed to be a transaction entered into between two associated enterprises, if there exists a prior agreement in relation to the relevant transaction between such other person (**i.e. there is a prior agreement of PQR Ltd.**) and the associated enterprise (**i.e. with C Inc.**), whether such other person is a non-resident or not (**i.e. whether PQR Ltd. is a non-resident or not**).

Therefore, considering the provisions of section 92B(2), A Ltd. is deemed to have entered into an international transaction with PQR Ltd and therefore, it is subject to transfer pricing regulations.

Readers Note:

- **Explanation to Section 92B**

Section 92B has been amended with retrospective effect from the assessment year 2002-03, to clarify that “international transaction” shall include—

- (a) the purchase, sale, transfer, lease or use of **tangible property** including building, transportation vehicle, machinery, equipment, tools, plant, furniture, commodity or any other article, product or thing;
- (b) the purchase, sale, transfer, lease or use of **intangible property**, including the transfer of ownership or the provision of use of rights regarding land use, copyrights, patents, trademarks, licences, franchises, customer list, marketing channel, brand, commercial secret, know-how, industrial property right, exterior design or practical and new design or any other business or commercial rights of similar nature;
- (c) capital financing, including any type of long-term or short-term **borrowing, lending** or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business;
- (d) **provision of services**, including provision of market research, market development, marketing management, administration, technical service, repairs, design, consultation, agency, scientific research, legal or accounting service;
- (e) a transaction of **business restructuring or reorganisation**, entered into by an enterprise with an associated enterprise, irrespective of the fact that it has bearing on the profit, income, losses or assets of such enterprises at the time of the transaction or at any future date;

- **Meaning of Intangible property**

Further, the expression “intangible property” shall include for the aforesaid purpose the following:-

- (a) marketing related intangible assets, such as, trademarks, trade names, brand names, logos;
- (b) technology related intangible assets, such as, process patents, patent applications, technical documentation such as laboratory notebooks, technical know-how;
- (c) artistic related intangible assets, such as, literary works and copyrights, musical compositions, copyrights, maps, engravings;
- (d) data processing related intangible assets, such as, proprietary computer software, software copyrights, automated databases, and integrated circuit masks and masters;
- (e) engineering related intangible assets, such as, industrial design, product patents, trade secrets, engineering drawing and schema-tics, blueprints, proprietary documentation;
- (f) customer related intangible assets, such as, customer lists, customer contracts, customer relationship, open purchase orders;
- (g) contract related intangible assets, such as, favourable supplier, contracts, licence agreements, franchise agreements, non-compete agreements;

- (h) human capital related intangible assets, such as, trained and organised work force, employment agreements, union contracts;
- (i) location related intangible assets, such as, leasehold interest, mineral exploitation rights, easements, air rights, water rights;
- (j) goodwill related intangible assets, such as, institutional goodwill, professional practice goodwill, personal goodwill of professional, celebrity goodwill, general business going concern value;
- (k) methods, programmes, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists, or technical data;
- (l) any other similar item that derives its value from its intellectual content rather than its physical attributes.

57.3 DETERMINATION OF THE ARM'S LENGTH PRICE

Section:- 92C and 92F(iii)

- **If conditions mentioned in Para 2 are satisfied, then**
 - (a) any income arising from an international transaction shall be computed having regard to arm's length price.
 - (b) Allowance for any expense or interest arising from international transaction shall also be determined having regard to arm's length price.
- **Meaning of Arm's length price [section 92 F(iii)]**

Arm's length price is the price which is applied or proposed to be applied in a transaction between persons other than associated enterprises, in uncontrolled conditions.

Therefore, following three elements of arm's length price are:

 - (a) The price which is applied or proposed to be applied in a transaction;
 - (b) The transaction is taking place between persons other than associated enterprises; and
 - (c) The transaction is taking place in an uncontrolled conditions.
- **Methods relevant for determination of Arm's Length Price [Section 92 C(1)]**

The arm's length price shall be determined by any of the following methods, being the most appropriate method, having regard to (a) nature of transactions (b) class of associated persons (c) functions performed by associated persons (d) other factors as the Board may prescribe.

 1. Comparable uncontrolled price method
 2. Resale Price Method
 3. Cost Plus Method
 4. Profit split Method
 5. Transaction Net Margin Method
 6. Such other Method as may be prescribed
- **Comparability of the international transaction with an uncontrolled transaction:- First step towards determination of Arm's Length Price**

The comparability of one transaction with another shall be judged with reference to the following factors namely –

 - (a) The specific characteristics of the property or services transferred in either transaction
 - (b) The functions performed taking into account assets employed or to be employed and the risks assumed by the respective parties to the transactions
 - (c) The contractual terms (whether or not such terms are formal or in writing) of the transactions which lay down explicitly or implicitly how the responsibilities risks and benefits are to be divided between the respective parties to the transactions

- (d) Conditions prevailing in the markets in which the respective parties to the transactions operate including the geographical location and size of the markets costs of labour and capital in the markets overall economic development and level of competition and whether the markets are wholesale or retail.

When two transactions are deemed to be comparable

An uncontrolled transaction shall be comparable to an international transactions, if –

- (a) None of the differences (if any) between the transactions being compared or between the enterprises entering into such transaction are likely to materially affect the price or cost charged or paid in or the profit arising from such transactions in the open market or
- (b) Reasonable accurate adjustments can be made to eliminate the material effects of such differences.

Data to be used for comparison

In case, the most appropriate method for determination of ALP of a transaction entered into on or after 1.4.2014, is the resale price method or cost plus method or the transactional net margin method, then, then the data to be used for analyzing the comparability of an uncontrolled transaction with an international transaction shall be –

- (a) the data relating to the current year; or
- (b) the data relating to the financial year immediately preceding the current year, if the data relating to the current year is not available at the time of furnishing the return of income by the assessee, for the assessment year relevant to the current year.

However, where the data relating to the current year is subsequently available at the time of determination of arm's length price of an international transaction or a specified domestic transaction during the course of any assessment proceeding for the assessment year relevant to the current year, then, such data shall be used for such determination irrespective of the fact that the data was not available at the time of furnishing the return of income of the relevant assessment year.

- **Most appropriate method : Second Step towards determination of Arm's Length Price**

The most appropriate method shall be the method which provides the most reliable measure of an arm's length price in relation to an international transaction.

For the purpose of selecting the most appropriate method, the following factors shall be taken into account, namely-

- (a) The nature and class of the international transaction
- (b) The class or classes of associated enterprises entering into the transaction and the functions performed by them taking into consideration assets employed or risk assumed
- (c) The availability coverage and reliability of data necessary for application of the method
- (d) The degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions.
- (e) The extent to which reliable and accurate adjustments can be made to account for differences if any between the transactions being compared and the enterprises entering into such transactions.
- (f) The nature extent and reliability of assumptions required to be made in application of a method.

- **Where more than one price is determined by the most appropriate method [Third proviso to section 92C(2)]**

In respect of international transaction or specified domestic transaction undertaken on or after 1.4.2014, where more than one price is determined by the most appropriate method, then the ALP shall be computed in the prescribed manner (based on "range concept" to be specified by way of Rules).

- **Non-applicability of provisions of “transfer pricing” [Section 92(3)]**

Section 92 (3) provides that the provisions of transfer pricing shall not be applicable in a case where the application of arm's length price has the effect of reducing income chargeable to tax or increasing the loss, as the case may be, computed on the basis of entries made in the books of account of the previous year in which the international transaction or specified domestic transaction was entered into.

57.4 MAINTENANCE AND KEEPING OF INFORMATION AND DOCUMENT BY PERSONS ENTERING INTO AN INTERNATIONAL TRANSACTION OR SPECIFIED DOMESTIC TRANSACTION

Section:- 92D and Rule 10D

- **Information and documents to be kept and maintained**

Every person who has entered into an international transaction or specified domestic transaction shall keep and maintain the following information and documents namely-

- A description of the ownership structure of the assessee enterprise with details of shares or other ownership interest held by other enterprises;
- A profile of the multinational group of which the assessee enterprise is part along with the name address, legal, status and country of tax residence of each of the enterprise comprised in the group with whom international transactions have been entered into by the assessee, and ownership linkages among them;
- A broad description of the business of the assessee and the industry in which the assessee operates and of the business of the associated enterprises with whom the assessee has transacted;
- The nature and terms (including prices) of international transactions entered into with each associated enterprise details of property transferred or services provided and the quantum and the value of each such transaction or class of such transaction;
- A description of the functions performed risks assumed and assets employed or to be employed by the assessee and by the associated enterprises involved in the international transaction;
- A record of the economic and market analyses, forecasts, budgets or any other financial estimates prepared by the assessee for the business as a whole and for each division or product separately which may have a bearing on the international transactions entered into by the assessee;
- A record of uncontrolled transactions taken into account for analysing their comparability with the international transactions entered into including a record of the nature terms and conditions relating to any uncontrolled transaction with third parties which may be of relevance to the pricing of the international transactions;
- A record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction;
- A description of the method considered for determining the arm's length price, in relation to each international transaction or class of transaction the method selected as the most appropriate method along with explanations as to why such method as so selected and how such method was applied in each case;
- A record of the actual working carried out for determining the arm's length price including details of the comparable data and financial information used in applying the most appropriate method and adjustments if any which were made to account for differences between the international transaction and the comparable uncontrolled transactions or between the enterprises entering into such transactions;
- The assumptions policies and price negotiations if any which have critically affected the determination of the arm's length price;

- l. Details of the adjustments, if any made to transfer prices to align them with arm's length prices determined under these rules and consequent adjustment made to the total income for tax purpose;
- m. Any other information data or document including information or data relating to the associated enterprise which may be relevant for determination of the arm's length price.

It is further provided that where the aggregate value of international transaction does not exceed Rs. 1 crore, it will not be obligatory to maintain the above information and documents. However, such assessee shall be required to substantiate that income arising from international transactions entered into by him has been computed in accordance with section 92.

- **Authentic documentation**

The information specified above shall be supported by authentic documentation which may include the following:

- (a) Official publications, reports, studies and data bases from the Government of the country of residences of the associated enterprise or of any other country;
- (b) Reports of market research studies carried out by institutions of national or international repute;
- (c) Price publications including stock exchange and commodity market quotations;
- (d) Published accounts and financial statements relating to the business affairs of the associated enterprise;
- (e) Agreements and contracts entered into with associated enterprises or with unrelated enterprises in respect of transactions similar the international transactions;
- (f) Letters and other correspondence documenting any terms negotiated between the assessee and the associated enterprise;
- (g) Documents normally issued in connection with various transactions under the accounting practices followed.

- **Time limit by which information and document mentioned above to be made available**

The information specified above should be made available by the assessee on or before the due date of submission of return of income.

- **Fresh documentation need not be maintained in case of continuity of international transaction more than one year**

Where an international transaction continues to have effect over more than one previous year fresh documentation need not be maintained separately in respect of each previous year unless there is any significant change in the nature or terms of the international transaction in the assumption made or in any other factor.

However, in case of significant change, fresh documentation as may be necessary, shall be maintained detailing the impact of the change on pricing of the international transaction.

- **Period for which above information and documents to be maintained**

The information and documents specified in above shall be kept and maintained for a period of 8 years from the end of the relevant assessment year.

- **Furnishing information or document to the assessing officer or Commissioner (Appeals)**

The Assessing Officer or Commissioner (Appeals) may in the course of any proceeding under this Act require any person who has entered into an international transaction to furnish any information or document in respect thereof within a period of 30 days from the date of receipt of notice issued in this regard.

The Assessing Officer or the Commissioner (Appeals) may, on an application made by such person, extend the above period by a further period not exceeding 30 days.

57.5 | REPORT FROM ACCOUNTANT**Section:- 92E**

Every person who has entered into an international transaction or specified domestic transaction during a previous year shall obtain a report from an accountant and furnish such report on or before the specified date (30th November of assessment year) in the prescribed form [Form No. 3CEB] duly signed and verified in the prescribed manner by such accountant and setting forth such particulars as may be prescribed.

57.6 | DETERMINATION OF ARM'S LENGTH PRICE BY ASSESSING OFFICER IN CERTAIN CASES AND COMPUTATION OF TOTAL INCOME**Section:- 92C(3) and 92C(4)**

- **Determination of arm's length price by the Assessing officer**

Subject to following, the Assessing officer may proceed to determine the arm's length in relation to international transaction or specified domestic transaction:

- (1) The proceeding for assessment of income is pending before him.
- (2) The Assessing Officer has material or information or document in his possession.
- (3) On the basis of such material or information or document, the Assessing Officer is of the 'opinion' that the-
 - (a) Arm's length price charged or paid in an international transaction or specified domestic transaction has not been determined in accordance with the section 92C(1) and 92 C(2); or
 - (b) Assessee has not kept and maintained information and document related to an international transaction or specified domestic transaction in accordance with the provisions contained in Section 92 D(1) and rules made in this behalf;
 - (c) Information or data used for consulting the arm's length price is not reliable or correct; or
 - (d) Assessee has failed to furnish within the time specified any information or document which was required to be furnished under section 92 D(3).

- **Opportunity of being heard must be given before determination of ALP by the assessing officer**

However, opportunity of being heard shall be given by the Assessing Officer by serving a notice calling upon the assessee to show cause, on a date and time to be specified in the notice, why the arm's length price should not be so determined on the basis of material or information or document in the possession of the Assessing Officer.

- **Computation of total income by the assessing officer after determination of arm's length price**

The Assessing Officer may compute the total income of the assessee having regard to arm's length price determined above.

- **No deduction under section 10AA or Chapter VIA on enhancement made by the assessing officer**

If the total income is enhanced by the assessing officer as mentioned above, then no deduction u/s 10AA or under Chapter VIA shall be allowed in respect of the increased quantum of total income.

- **Computation of total income of payee associated enterprise not required in certain circumstances**

Computation of total income of payee associated enterprise is not required if –

- (a) Total income of payer associated enterprise has been computed by the assessing officer and
- (b) Tax has been deducted or deductible at source by the payer enterprise.

57.7 REFERENCE TO TRANSFER PRICING OFFICER**Section:- 92CA**

- Section 92CA provides that the Assessing Officer (if he considers it necessary or expedient to do so) may, with the previous approval of the Commissioner, refer the matter of determination of arm's length price (ALP) in respect of an international transaction or specified domestic transaction to the Transfer Pricing Officer (TPO). For the purposes of this section, "Transfer Pricing Officer" means a Joint Commissioner or Deputy Commissioner or Assistant Commissioner authorised by the Board to perform all or any of the functions of an Assessing Officer specified in sections 92C and 92D in respect of any person or class of persons.
- The TPO is further empowered to determine ALP of an international transaction or specified domestic transaction noticed by him in the course of proceedings before him, even if the said transaction was not referred to him by the Assessing Officer, provided that such international transaction or specified domestic transaction was not reported by the taxpayer as per the requirement cast upon him under section 92E.
- The Transfer Pricing Officer, thereafter, shall serve a notice on the assessee requiring him to produce or cause to be produced on a date to be specified therein, any evidence on which the assessee may rely in support of the computation made by him of the arm's length price in relation to the international transaction or specified domestic transaction.
- After hearing the assessee and the evidence the assessee may produce, including any information or documents referred to in section 92D(3) and after considering such evidence as the Transfer Pricing Officer may require on any specified points and after taking into account all relevant materials which he has gathered, the Transfer Pricing Officer shall, by order in writing, determine the arm's length price in relation to the international transaction or specified domestic transaction and send a copy of his order to the Assessing Officer and to the assessee.
- **On receipt of the order from TPO, the Assessing Officer shall proceed to compute the total income of the assessee in conformity with the arm's length price as so determined by the Transfer Pricing Officer.**
- With a view to rectifying any mistake apparent from the record, the Transfer Pricing Officer may amend any order passed by him, and the provisions of section 154 shall apply accordingly.
- The Transfer Pricing Officer may, for the purposes of determining the arm's length price under this section, exercise all or any of the powers specified in
 - Section 131(1) – clause (a) to (d)
 - Section 133(6)
 - Section 133A

UNIT B – DOMESTIC TRANSACTIONS**57.8 SPECIFIED DOMESTIC TRANSACTIONS****Section:- 92BA**

Section 92BA has been inserted with effect from the assessment year 2013-14. It provides the meaning of "specified domestic transaction" with reference to which the income is to be computed under section 92, having regard to arm's length price. The following transactions are covered within the meaning of "specified domestic transactions" if the aggregate of these transactions entered into by the assessee in a previous year exceeds Rs. 5 crore **[Rs. 20 crore w.e.f A.Y. 2016-17 as amended by Finance Act, 2015]**.

- (a) ~~any expenditure in respect of which payment has been made or is to be made to a person referred to in section 40A(2)(b);~~ **Omitted w.e.f. A.Y. 2017-18**
- (b) any transaction referred to in section 80A;
- (c) any transfer of goods or services referred to in section 80-IA(8) **[Refer example given below];**
- (d) any business transacted between the assessee and other person as referred to in section 80-IA(10);

(e) any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions section 80-IA(8)/(10) are applicable; or

(f) any other transaction as may be prescribed,

Any allowance for an expenditure or interest or allocation of any cost or expense or any income in relation to the above domestic transactions shall be computed having regard to the arm's length price.

For this purpose, arm's length price shall be determined within the parameters of sections 92 to 92F.

Practical 2

Ganga Ltd., a domestic company, has two units Chambal and Damodar. The Chambal unit, which commenced business two years back, is engaged in the business of developing an irrigation project. The Damodar unit is carrying on the business of trading in water pumps. During the previous year 2017-18, the Damodar unit transferred water pumps amounting to Rs. 19.5 crores to the Chambal unit.

Further, Ganga Ltd hires vehicles owned by Mr. Krishna's daughter and paid hiring charges of Rs. 1.5 crores during the previous year **2017-18**. Mr. Krishna, a resident Indian, holds 30% equity share capital in Ganga Ltd. Discuss whether the above transactions fall within the meaning of "specified domestic transaction"?

Solution

The Chambal Unit is eligible for deduction@100% of the profits derived from its eligible business (i.e., the business of developing an infrastructure facility, being an irrigation project) under section 80-IA. However, the Damodar Unit is not engaged in any "eligible business". Since the Damodar Unit has transferred water pumps to the Chambal Unit, it is an inter-Unit transfer of goods between eligible business and other business. Therefore, this transaction falls within the meaning of "specified domestic transaction" to attract transfer pricing provisions. The payment of hiring charges has been made to a related person referred to in section 40A(2)(b) i.e., relative (i.e., daughter) of Mr. Krishna, who has substantial interest in the business of Ganga Ltd. **However, due to amendment made by Finance Act, 2017, this transaction does not fall within the meaning of "specified domestic transaction" under section 92BA.**

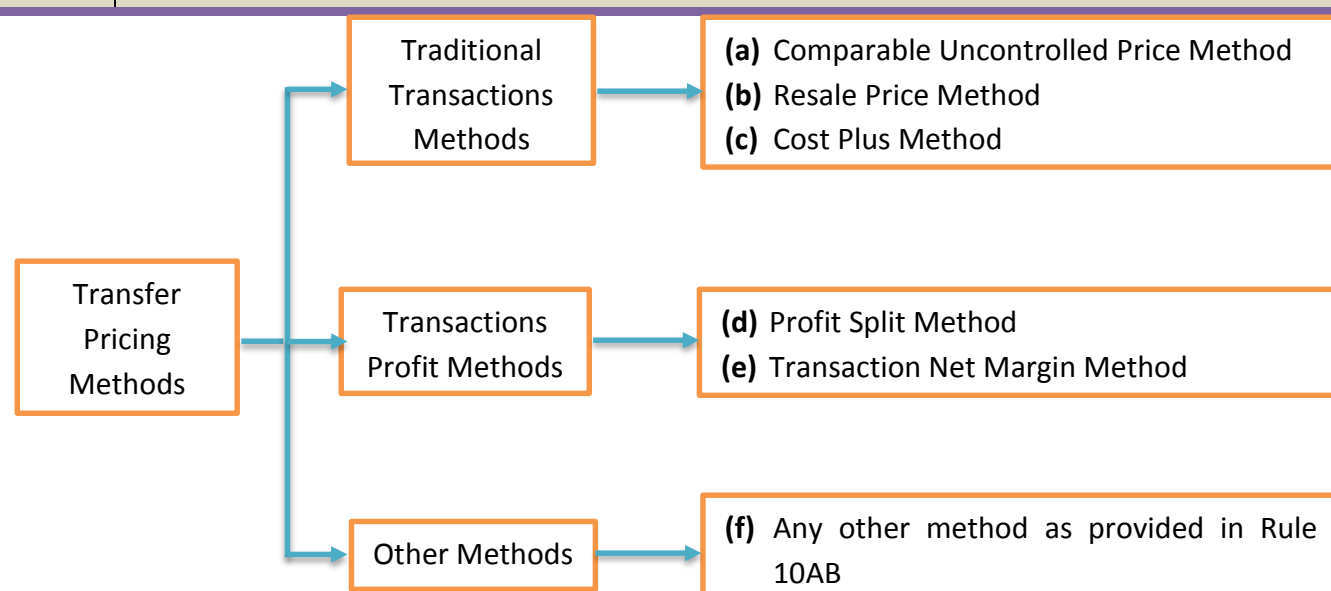
It is imperative to note here that; abovementioned transactions would be treated as a "specified domestic transaction" to attract transfer pricing provisions only if the aggregate of such transactions as specified in section 92BA during the year by Ganga Ltd. exceeds a sum of Rs. 20 crore.

Since aggregate of these transactions is Rs. 19.5 crore which is not exceeding Rs. 20 crore. Therefore, the said transactions are outside the purview of "specified domestic transaction".

Readers Note:

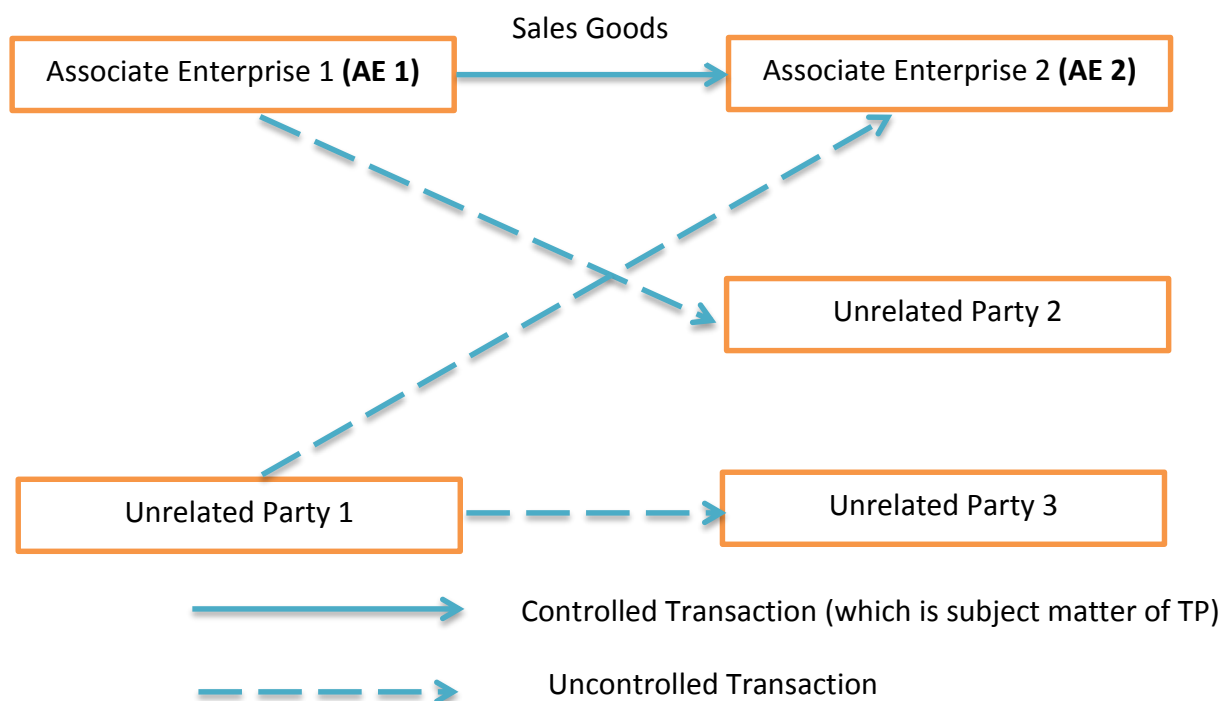
UNIT C – METHODS FOR DETERMINATION OF ARM'S LENGTH PRICE

57.9 TRANSFER PRICING METHODS – SIX METHODS (a) to (f)



57.10 | COMPARABLE UNCONTROLLED PRICE METHOD [CUP]

- A. The price charged or paid for property transferred or services provided in a comparable uncontrolled transaction or a number of such transactions, is identified;
- B. Such price is adjusted to account for differences, if any, between the international transaction or (the specified domestic transaction) and the comparable uncontrolled transactions or between the enterprises entering into such transactions which could materially affect the price in the open market;
- C. The adjusted price arrived at under (b) *above* is taken to be an arm's length price in respect of the property transferred or services provided in the international transaction or the specified domestic transaction.

**Practical 3**

Kio, a company based at Japan and AB Ltd, an Indian Company are Associated Enterprises. AB Ltd manufactures Cellular Phones and sells them to Kio, Japan and also to Geel, a Company based at Beijing. During the year AB Ltd supplied 2,50,000 Cellular Phones to Kio, Japan at a price of Rs. 3,000 per unit and 35,000 units to Geel at a price of Rs. 4,800 per unit. The transactions of AB Ltd with Kio and Geel are comparable subject to the following considerations -

- (a) Sales to Kio is on FOB basis, sales to Geel are CIF basis. Freight and Insurance paid by Kio for each unit is Rs. 700.
- (b) Sales to Geel are under a free warranty for Two Years whereas sales to Kio are without any such warranty. The estimated cost of executing such warranty is Rs. 500.
- (c) Since Kio's order was huge in volume, quantity discount of Rs. 200 per unit was offered to it.

Compute Arm's Length Price and amount of increase in Total Income of AB Ltd, if any, due to such Arm's Length Price

Solution**Computation of Arm's Length Price of Products sold to Kio Japan by AB Ltd**

Particulars	Rs.	Rs.
Price per Unit in a Comparable Uncontrolled Transaction		4,800
Less: Adjustment for Differences -		
(a) Freight and Insurance Charges	(700)	
(b) Estimated Warranty Costs	(500)	
(c) Discount for Voluminous Purchase	(200)	(1,400)
Arm's Length Price for Cellular Phone sold to Kio Japan		3,400

Computation of Increase in Total Income of AB Ltd.

Particulars	Rs.	Rs.
Arm's Length Price per Unit		3,400
Less: Price at which actually sold to Kio Japan		(3,000)
Increase in Price per Unit		400
No. of Units sold to Kio Japan		2,50,000
Therefore, increase in Total Income of AB Ltd (2,50,000 × Rs.400)		10 Crores

Readers Note:**57.11 RESALE PRICE METHOD [RPM]**

- A. The price at which property purchased or services obtained by the enterprise from an associated enterprise is resold or are provided to an unrelated enterprise is identified;
- B. Such resale price is reduced by the amount of a normal gross profit margin accruing to the enterprise or to an unrelated enterprise from the purchase and resale of the same or similar property or from obtaining and providing the same or similar services in a comparable uncontrolled transaction or a number of such transactions;
- C. The price so arrived at is further reduced by the expenses incurred by the enterprise in connection with the purchase of property or obtaining of services;
- D. The price so arrived at is adjusted to take into account the functional and other differences including differences in accounting practices, if any, between the international transaction or (specified domestic transaction) and the comparable uncontrolled transactions, or between the enterprises entering into such transactions which could materially affect the amount of gross profit margin in the open market;
- E. The adjusted price arrived at under (d) above is taken to be an arm's length price in respect of the purchase of the property or obtaining of the services by the enterprise from the associated enterprise.



Resale price	100
Gross Profit Margin (20% on sale)	
Arm's Length Price (?)	

Practical 4

MNO Ltd. and Roxy Inc. of U.S.A are associated enterprises. MNO Ltd. imports 3,000 motors bikes from Roxy Inc. at Rs.50,000 per bike. These are sold in India at Rs.55,000 per bike. Also, MNO Ltd. imported exactly similar motor bikes from Hold Inc. of Japan (unrelated party) and sold outside at a Gross Profit of 20% on Sales.

Roxy Ltd, offered a quantity discount of Rs. 1,500 per motor vehicle. Hold Inc., however, offered only Rs.500 per bike as quantity discount. The freight and insurance from Roxy USA cost MNO Ltd. Rs.1,500 per bike whereas in respect of purchase from Hold Inc. MNO Ltd. had to pay Rs.500 as freight charges and there was no insurance cost to the assessee.

Determine the Arm's Length Price and the amount of increase in Total Income of Rani Ltd.

Solution**A. Computation of Arm's Length Price of Products bought from MNO Ltd.**

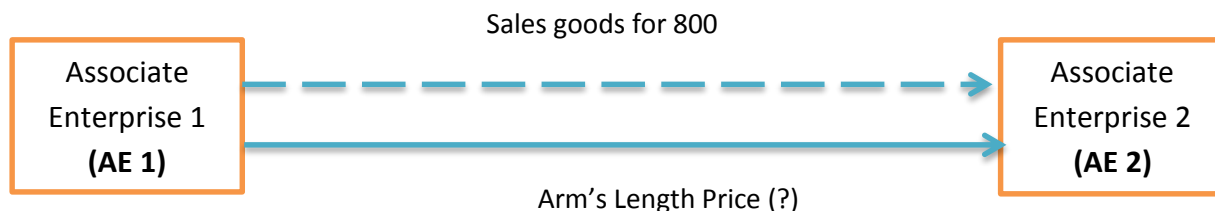
Particulars	Rs.
Resale Price of Goods Purchased from MNO Ltd.	55,000
Less: Adjustment for differences	
(a) Normal gross profit margin @ 20% of sale price [20% × Rs. 55,000]	(11,000)
(b) Incremental Quantity Discount by MNO Ltd. [Rs. 1,500 – Rs. 500]	(1,000)
(c) Difference in Purchase related Expenses [Rs. 1,500 – Rs. 500]	(1,000)
Arms Length Price	42,000

B. Computation of Increase in Total Income of Rani Ltd

Particulars	Rs.
Price at which actually bought	50,000
Less : Arm's Length Price per unit under Resale Price Method	(42,000)
Decrease in Purchase Price per bike	8,000
No. of Units purchased	3,000
Increase in Total Income of Rani Ltd [3,000 Units × Rs. 8000]	2,40,00,000

Readers Note:**57.12 COST PLUS METHOD [CPM]**

- The direct and indirect costs of production incurred by the enterprise in respect of property transferred or services provided to an associated enterprise, are determined;
- The amount of a normal gross profit mark-up to such costs (computed according to the same accounting norms) arising from the transfer or provision of the same or similar property or services by the enterprise or by an unrelated enterprise in a comparable uncontrolled transaction or a number of such transactions is determined;
- The normal gross profit mark-up referred to in (b) above is adjusted to take into account the functional and other differences if any between the international transaction or (the specified domestic transaction) and the comparable uncontrolled transactions or between the enterprises entering into such transactions, which could materially affect such profit mark-up in the open market;
- The costs referred to in (a) above are increased by the adjusted profit mark-up arrived at under (c) above;
- The sum so arrived at is taken to be an arm's length price in relation to the supply of the property or provision of services by the enterprise.



Cost of Associate Enterprise (AE 1)	500
+ Gross Profit Mark-up (50%)	
Arm's Length Price	

Practical 5

NANO Inc., a German Company, holds 45% of equity in Hitech Ltd., an Indian Company. Hitech Ltd. is engaged in development of software and maintenance of the same for customers across the globe. Its clientele includes NANO Inc.

During the financial year 2015-16, Hitech Ltd. had spent 2400 man hours for developing and maintaining software for NANO Inc. with each hour being billed at Rs. 1,300. Cost incurred by Hitech Ltd. for executing work for NANO Inc. amounts to Rs. 20 lakhs.

Hitech Ltd. had also undertaken developing software for Modi Industries, for which Hitech Ltd. had billed at Rs. 2,700 per man hour. The persons working for Modi Industries and NANO Inc. were part of the same team and were of matching credentials and calibre. Hitech Ltd. made a gross profit of 60% on Modi Industries work. Hitech Ltd.'s transactions with NANO Inc. are comparable to transactions with Modi Industries, subject to the following differences:

- (i) NANO Inc. gives technical knowhow support to Hitech Ltd., which can be valued at 8% of the normal gross profit. Modi Industries does not provide any such support.
- (ii) Since the work for NANO Inc. involved huge number of man hours, a quantity discount of 14% of normal gross profits was given.
- (iii) Hitech Ltd. had offered 90 days credit to NANO Inc., the cost of which is measured at 2% of the normal billing rate. No such credit was offered to Modi Industries.

Compute arm's length price as per cost plus method and the amount of increase in total income of Hitech Ltd.

Solution**Computation of Arm's Length Price as per Cost Plus Method**

Particulars	(%)
Gross Profit Mark up in case of Modi Industries [an unrelated party]	60.00
Less: Differences to be adjusted	
Value of technical know-how (8% of 60%)	(4.80)
Quantity discount to Nano Inc. (14% of 60%)	(8.40)
	46.80
Add: Cost of credit to Nano Inc., an associated enterprise (2% of 100%)	2.00
Arm's length gross profit mark up	48.80

Computation of Increase in Total Income of Hitech Ltd

Particulars	Rs.
Cost incurred by Hitech Ltd. for executing Nano Inc's work. [100% - 48.8%=51.2%]	20,00,000
Add: Adjusted gross profit (Rs. 20,00,000 x 48.8/51.2)	19,06,250
Arm's length billed value	39,06,250

Less: Actual Billed Income in the case of Nano Inc (Rs. 1300 x 2400 man hours)	31,20,000
Total Income of Hitech Ltd to be increased by	7,86,250

Readers Note:**57.13 PROFIT SPLIT METHOD [PSM]**

This method may be applicable mainly in international transactions (or specified domestic transactions) involving transfer of unique intangibles or in multiple international transactions (or specified domestic transactions) which are so interrelated that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction.

- A. The combined net profit of the associated enterprises arising from the international transactions (or specified domestic transactions) in which they are engaged, is determined;
- B. The relative contribution made by each of the associated enterprises to the earning of such combined net profit is then evaluated on the basis of the functions performed assets employed or to be employed and risks assumed by each enterprise and on the basis of reliable external market data which indicates how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances;
- C. The combined net profit is then split amongst the enterprises in proportion to their relative contributions as evaluated under (b) above;
- D. The profit thus apportioned to the assessee is taken into account to arrive at an arm's length price in relation to the international transaction (or the specified domestic transaction)

Practical 6

U Ltd. - Foreign co. holds 40% equity of I Ltd., Indian co. I Ltd. purchased goods from U Ltd. at 90 € per piece. Thereafter, I Ltd. sell these goods in India at 160 € per piece to unrelated parties. Cost/expenses incurred by U Ltd. is 45 € per piece, while cost incurred by I Ltd. in India is 63 € per piece. Considering asset employed, risk assumed and function performed, factor for distribution of profit between U Ltd. and I Ltd. is 60:40. Decide whether transaction between U Ltd. & I Ltd. is at arm's length price.

Solution**Readers Note:****Practical 7**

HUM Medical Equipments Inc. (HUM) of Canada has received an order from a leading UK based Hospital for development of a hi-tech medical equipment which will integrate the best of software and latest medical examination tool to meet varied requirements. The order was for 2,50,000 Euros.

To execute the order, HUM joined hands with its subsidiary CARE Components Inc. (CCI) of USA and Bioinformatics India Ltd (BIL), an Indian Company. CCI holds 40% of BIL. HUM paid to CCI and BIL Euro 70,000 and Euro 80,000 respectively and kept the balance for itself. In the entire transaction, a profit of Euro 80,000 is earned. Bioinformatics India Ltd incurred a Total Cost of Euro 75,000 in execution of its work in the above contract. The Relative Contribution of HUM, CCI and BIL may be taken at 35%, 25% and 40% respectively. Compute the Arm's Length Price and the incremental Total Income of Bioinformatics India Ltd, if any due to adopting Arm's Length Price determined in this case.

Solution

Particulars	Euros.
(A) Share of each of the Associates in the Combined Net Profit of 80,000 Euros	
Share of BIL [Contribution of 40% x 80,000]	32,000
Share of CCI [Contribution of 25% x 80,000]	20,000
Share of HUM [Contribution of 35% x 80,000]	28,000
(B) Computation of Incremental Total Income of BIL	
Total Cost to Bioinformatics India Ltd	75,000
Add: Share in the Profit to BIL (from above)	32,000
Revenue of BIL on the basis of Arm's Length Price	1,07,000
Less: Revenue Actually received by BIL	(80,000)
Increase in Total Income of BIL	27,000

Readers Note:**57.14 TRANSNATIONAL NET MARGIN METHOD [TNMM]**

- The net profit margin realized by the enterprise from an international transaction (or specified domestic transaction) entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;
- The net profit margin realized by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;
- The net profit margin referred to in (b) (supra) arising in comparable uncontrolled transactions is adjusted to take into account the differences if any between the international transaction (or the specified domestic transaction) and the comparable uncontrolled transactions, or between the enterprises entering into such transactions which could materially affect the amount of net profit margin in the open market;
- The net profit margin realized by the enterprise and referred to in (a) above is established to be the same as the net profit margin referred to in (c) above;
- The net profit margin thus established is then taken into account to arrive at an arm's length price in relation to the international transaction.

Given Price	USD 10,000
Cost of Goods Sold	?
Gross Profit	?
Operating Expenses	USD 2000
Net Profit (5% of Price)	USD 400

The AE1 has purchased raw materials from its AE2 and manufactures goods for sale to third parties. The similar transaction is entered into by unrelated parties with net margin of 5% of sale price. Thus, if AE1 earns net margin of 5% of sale price, then its transaction of purchase of raw materials from AE2 will be at arm's length

57.15 OTHER METHOD AS MAY BE PRESCRIBED BY THE BOARD

Notification No. 18/2012 dated 23.05.2012 : Rule 10AB inserted to provide for "Other method of determination of arm's length price"

Accordingly, Rule 10AB has been inserted in the Income-tax Rules, 1962 to provide that for the purposes of section 92C(1)(f), the **other method** for determination of the arm's length price in relation to an international transaction shall be any method which takes into account the price which has been charged or paid, or would have been charged or paid, for the same or similar uncontrolled transaction, with or between **non-associated enterprises**, under similar circumstances, considering all the relevant facts.

57.16 HOW TO DETERMINE ALP WHEN MORE THAN ONE PRICE IS DETERMINED? – RANGE CONCEPT

Third proviso to Section 92 C (2) and Notification:- 83/2015, dated 19.10.2015 (Rule : 10CA)

- Where more than one price is determined by the most appropriate method, the arm's length price in relation to an international transaction or specified domestic transaction undertaken on or after the 1st day of April, 2014, shall be computed in such manner as may be prescribed.
- Accordingly, Central Board of Direct Taxes (CBDT) has, vide Notification No. 83/2015 dated 19th October, 2015, issued the final rules (*Rule 10CA*) to give effect to 'range concept' which were introduced by Finance Act, 2014.
- Rule 10 CA (4) provides that, the 'range concept' shall be applicable when:**
 - the MAM is either Comparable Uncontrolled Price (CUP) Method, RPM, CPM, or TNMM; and
 - there are at least 6 comparables.

Where these conditions are not fulfilled, 'arithmetic mean' shall apply, along with the tolerance range benefit (3% or 1%) as discussed below : vide notification no. 50/ 2017 dated 09.06.2017

"Where the variation between the arm's length price determined under section 92C and the price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed one percent of the latter in respect of wholesale trading and three percent of the latter in all other cases, the price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price for Assessment Year 2017-2018 and Assessment Year 2018-19"

- For the determination of the quartiles, the margins in the data set (i.e., set of comparable companies) are required to be arranged in ascending order and the arm's length range would be data points lying between the 35th and 65th percentile of the data set.
- If the transaction price falls within the range, then the same shall be deemed to be the ALP. If the transaction price falls outside the range, the ALP shall be taken to be the Median of the data set.
- The computation mechanism of range is explained by way of illustrations below:

Illustration 1

Where the data set comprises 7 data points (arranged in ascending order), and the percentiles computed are not whole numbers

Percentile	Formula	Result	Value to be selected
35 th	Total no. of data points in dataset x 35% = [7 x 35%]	2.45	3 rd Value*
65 th	Total no. of data points in dataset x 65% = [7 x 65%]	4.55	5 th Value*
Median	Total no. of data points in datasets x 50% = [7 x 0.5]	3.50	4 th Value*

* Value referred to here is the place value in the data set as arranged in ascending order.

Illustration 2

Where the data set comprises 20 data points (arranged in ascending order), and the percentiles computed are whole numbers.

Percentile	Formula	Result	Value to be selected
35 th	Total no. of data points in dataset x 35%=[20 x 35%]	7	Mean of 7 th & 8 th Value
65 th	Total no. of data points in dataset x 65% = [20 x 65%]	13	Mean of 13 th & 14 th Value
Median	Total no. of data points in datasets x 50% = [20 x 0.5]	10	Mean of 10 th & 11 th Value

Practical 8

In a given case the dataset of 20 prices arranged in ascending order is as under :

Sl. No.	Prices (in Rs. Thousand)	Sl. No.	Prices (in Rs. Thousand)
1	42.00	11	48.45
2	43.00	12	48.48
3	44.00	13	48.50
4	44.50	14	49.00
5	45.00	15	49.10
6	45.25	16	49.35
7	47.00	17	49.50
8	48.00	18	49.75
9	48.15	19	50.00
10	48.35	20	50.15

You are required to find out whether following transactions have been carried out Arm's Length Price? If not, then what shall be the Arm's Length Price?

Transaction 1 : Rs. 48,000

Transaction 2 : Rs. 46,500

Solution

The data place of the thirty-fifth and sixty-fifth percentile is determined as follows:

Thirty-fifth percentile place = $20 * (35/100) = 7$.

Sixty-fifth percentile place = $20 * (65/100) = 13$.

Since the thirty-fifth percentile place is a whole number, it shall be the average of the prices at the seventh and next higher, i.e.; eighth place. This is $(47+48)/2 = \text{Rs.}47,500$.

Similarly, the sixty-fifth percentile will be average of thirteenth and fourteenth place prices. This is $(48.5+49)/2=\text{Rs.}48,750$

Thus, the arm's length range in this case shall be from Rs.47,500 to Rs.48,750.

The median of the range (the fiftieth percentile place) = $20*(50/100)=10$

Since the fiftieth percentile place is a whole number, it shall be the average of the prices at the tenth and next higher, i.e.; eleventh place. This is $(48.35+48.45)/2= \text{Rs.}48,400$.

Considering the above,

Particulars	Has it been carried out at ALP?	What shall be the ALP?
Transaction 1		
Transaction 2		

Readers Note:

Practical 9

Tiku Private Ltd., an Indian company, provides software support services to XYZ Inc.(U.S.A), for a consideration of Rs. 50 lakhs. It charges Rs. 51 lakhs and Rs. 53 lakhs for similar services rendered to PQR Inc. and MNO Inc., respectively. XYZ Inc. and Tiku Pvt. Ltd are associated enterprises. Whether the transfer price charged by Tiku Private Ltd. shall be accepted?

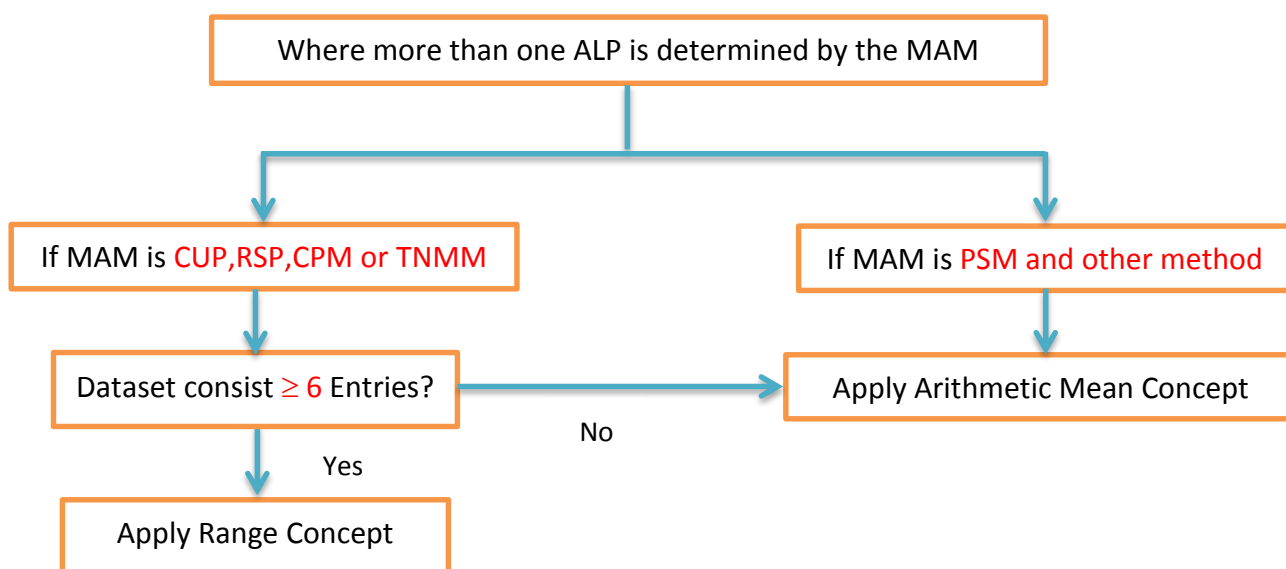
Solution

Following Comparable Uncontrolled Price (CUP) Method and considering the Rule 10CA(7), $ALP = (Rs. 51 \text{ lakhs} + 53 \text{ lakhs}) / 2 = Rs. 52 \text{ Lakh}$

On the other hand Transfer price = Rs. 50,00,000

Permissible variation is 3% of transfer price being Rs.1.5 lac resulting into a range of [48.5 lac to 51.5 lac]

Since the ALP being Rs. 52 Lac does not fall within the range, transfer price charged by Tiku Pvt. Ltd. shall not be accepted.

Readers Note:**Summary of Range Concept****57.17 USE OF MULTIPLE YEAR DATA AND RANGE CONCEPT**

Notification:- 83/2015, dated 19.10.2015

- As per the notification issued by CBDT, use of multiple year data (of the comparable companies for the purpose of comparability analysis) is applicable only in cases where RPM, CPM or TNMM has been selected as the Most Appropriate Method.
- Thus, in cases where CUP, PSM or Other Method are selected as the Most Appropriate Method, multiple year data of comparable companies cannot be used.
- For each comparable selected (under RPM, CPM or TNMM), the data of the current year is required to be considered. In case such data is not available at the time of furnishing the return of income, data pertaining to up to two preceding financial years may be used.
- If a comparable is selected on the basis of preceding year data, but is not found to be comparable for the current year for qualitative or quantitative reasons, then such comparable would need to be rejected from the data set.
- When using multiple year data, data for each comparable shall be the weighted average of the selected years.
- The weighted average of the prices of such transactions shall be computed in the following manner, namely:-

Sr. No.	Method used to determine the prices	Manner of computation of weighted average of the prices
(i)	The resale price method	By assigning weights to the quantum of sales which has been considered for arriving at the respective prices
(ii)	The cost plus method	By assigning weights to the quantum of costs which has been considered for arriving at the respective prices
(iii)	The transactional net margin method	By assigning weights to the quantum of costs incurred or sales effected or assets employed or to be employed, or as the case may be, any other base which has been considered for arriving at the respective prices

Question

What are the difficulties arises in applying the arm's length principle?

Answer

The arm's length principle, although survives upon the international consensus, does not necessarily mean that it is perfect. There are difficulties in applying this principle in a number of situations.

- The most serious problem is the need to find transactions between independent parties which can be said to be exact compared to the controlled transaction.
- It is important to appreciate that in an MNE system, a group first identifies the goal and then goes on to create the associated enterprise and finally, the transactions entered into. This procedure obviously does not apply to independent enterprises. Due to these facts, there may be transactions within an MNE group which may not be between independent enterprises.
- Further, the reductionist approach of splitting an MNE group into its component parts before evaluating transfer pricing may mean that the benefits of economies of scale, or integration between the parties, is not appropriately allocated between the MNE group.
- The application of the arm's length principle also imposes a burden on business, as it may require the MNE to do things that it would otherwise not do (i.e. searching for comparable transactions, documenting transactions in detail, etc).
- Arm's length principle involves a lot of cost to the group.

Readers Note:**57.18 EXTRA PRACTICALS****Practical 10**

X Inc., a company in U.S.A. sells gift articles to its Indian subsidiary A Ltd. @\$5 per gift article. The assessing officer notice that X Inc. sells same gift articles to another company B Ltd. in India @\$4.5 per gift article. Total income of A Ltd. for the relevant assessment year is Rs.15,00,000 after making payment for 1000 gift articles @\$5. Compute the total income of A Ltd to be determined by the assessing officer. Assume 1 US \$=Rs. 65 for the sake of simplicity. Will computation of total income of X Inc. is required by the assessing officer under chapter transfer pricing?

Solution

Arm's length price in respect of gift article shall be \$4.5 per gift article following CUP method.

Computation of total income in the hands of A Ltd. by the assessing officer

Particulars	Rs.
Total Income reported by A Ltd.	15,00,000
Add: Amount paid to X Inc. (\$5 X 1000 X Rs. 65)	3,25,000

Less: Purchase to be recorded at Arm's length price (\$4.5 X 1000 X 65)	2,92,500
Total Income	15,32,500

Computation of total income of X Inc.

As discussed earlier, computation of payee associated enterprise (X Inc) is not required if-

- (a) Total income of payer associated enterprise (A Ltd.) has been computed by the A.O and
- (b) Tax has been deducted or deductible at source by the payer enterprise.

Readers Note:**Practical 11**

Suppose in the above problem X Inc. sells gift article @ \$6 to B Ltd. in India, find out the total income of A Ltd. to be determined by the assessing officer.

Solution

Arm's length price in respect of gift article shall be \$ 6 per gift article following CUP method.

Computation of total income in the hands of A Ltd. by the assessing officer

Particulars	Rs.
Total Income reported by A Ltd.	15,00,000
Add: Amount paid to X Inc. (\$5 X 1000 X Rs. 65)	3,25,000
Less: Purchase to be recorded at Arm's length price (\$6 X 1000 X 65)	3,90,000
Total Income	14,35,000

By virtue of section 92(3) one cannot reduce taxable income by applying arm's length price.

Therefore income of A Ltd. will be Rs. 15,00,000.

Readers Note:**Practical 12**

EF Limited, an Indian company, is engaged in manufacturing electronic components. 74% of shares of the company are held by EF Inc., incorporated in USA. EF Limited has borrowed funds from EF Inc. at LIBOR plus 150 points. The LIBOR prevalent at the time of borrowing is 4% for US \$. The borrowings allowed under the External Commercial Borrowings guidelines issued under Foreign Exchange Management Act are LIBOR plus 200 basis points. Discuss whether the borrowing made by EF Limited is at arm's length ('LIBOR' means London Inter-Bank Offer Rate).

Solution

EF Inc., USA and EF Limited, the Indian company are associated enterprises since the former holds 74% shares in the latter.

The arm's length rate of interest can be determined by using CUP method having regard to the rate of interest on external commercial borrowing permissible as per guidelines issued under FEMA Act.

The interest rate permissible is LIBOR plus 200 basis points i.e., 4% + 2% = 6%, which can be taken as the arm's length rate. The interest rate applicable on the borrowing by EF Limited, India from EF Inc., USA, is LIBOR plus 150 basis points i.e., 4% + 1.5% = 5.5%. Since the rate of interest, i.e. 5.5% is less than the arm's length rate of 6%, the borrowing made by the EF Ltd. is not at arm's length.

However, in this case, the taxable income of EF Ltd., India, would be lower if the arm's length rate is applied. Hence, no adjustment is required since the law of transfer pricing will not apply if there is a negative impact on the existing profits.

Readers Note:

Practical 13

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 31.3.2017:

- (i) 10,000 cars sold to Rida Ltd. which holds 30% shares in Anush Motors Ltd. at a price which is less by \$ 200 each car than the price charged from Shingto Ltd.
- (ii) Royalty of \$ 1,20,00,000 was paid to Kyoto Ltd. for use of technical know-how in the manufacturing of car. However, Kyoto Ltd. had provided the same know-how to another Indian company for \$ 90,00,000.
- (iii) Loan of Euro 1000 crores carrying interest @ 10% p.a. advanced by Dorf Ltd., a German company, was outstanding on 31.3.2017. 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.2017-18 keeping in mind that the value of 1\$ and of 1 EURO was Rs.63 and Rs.84, respectively, throughout the year.

Solution

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 more particularly section 92A(2) speaks of thirteen situations when the two enterprises shall be deemed to associated enterprises. Applying the provisions of section 92A(2) to the given facts, “Anush Motors Ltd.” and the followings are the “associated enterprises”:-

Rida Ltd., because this company holds shares carrying more than 26% of the voting power in Anush Motors Ltd.;
Kyoto Ltd., since this company is the sole owner of the technology used by Anush Motors Ltd. in its manufacturing process;

Dorf Ltd., since this company has granted loans 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 as under so as to find out total income for the A.Y. 2017-18.

Particulars	(Rs.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)	18.90
(iii) Difference for excess interest paid on loan of EURO 1000 crores($84 \times 1000 \times 1/100$)	840.00
Total Income	1,171.50

Readers Note:

Practical 14

‘Examine the correctness or otherwise of the following with reference to the provisions of the Income-tax Act, 1961.

“Transfer pricing rules shall have no implication where income is computed on the basis of book profits under section 115JB of the Income Tax Act.”

Solution

The statement is correct.

Reason: 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, it is discovered that the profit and loss account is not drawn up in accordance with the relevant Schedule of the Companies Act. Therefore, transfer pricing adjustments cannot be made while computing book profit for levy of MAT.

Readers Note:

UNIT D – SAFE HARBOUR RULES

57.19 | OVERVIEW OF THE REQUIREMENTS AND PROCEDURE TO OPT FOR SAFE HARBOUR

Rule:- 10TE

Requirements

- The benefit of Safe Harbour is available to an eligible assessee (See Rule 10 TB)
- The eligible assessee must have entered into an eligible transaction (Rule 10TC)
- He must have exercised the option of safe harbor and the option exercised by the said assessee is not held to be invalid under Rule 10TE.
- The assessee shall not be entitled to invoke mutual agreement procedure under DTAA for the transactions under Safe Harbour regime.

Procedure (Rule 10 TE)

- To exercise the option of safe harbour, the taxpayer is required to file specified form (Form No 3CEFA or 3CEFB) with the AO on or before due date of furnishing the return of income with required details for:
 - (a) the relevant assessment year, in case the option is exercised only for that assessment year; or
 - (b) the first of the assessment years, in case the option is exercised for more than one assessment years.
- The taxpayer can opt out of the safe harbour regime from the second year onwards, by filing a declaration to that effect with the AO.

57.20 | SAFE HARBOR RULE NOT TO APPLY IN CERTAIN CASES

Rule:- 10TF

Nothing contained in rules 10TA, 10TB, 10TC, 10TD or rule 10TE shall apply in respect of eligible international transactions entered into with an associated enterprise located in any country or territory notified under section 94A (Popularly known as NJA) or in a no tax or low tax country or territory.

57.21 | SAFE HARBOUR

Rule:- 10TD

The revised Safe Harbor rules are tabulated below:

Sr. No.	Eligible International Transaction	Circumstances in which tax authorities shall accept the transfer price declared by the assessee
(1)	(2)	(3)
1.	Provision of software development services referred to in item (i) of rule 10TC.	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is - (i) not less than 17 per cent, <u>where the value of international transaction does not exceed a sum of one hundred crore rupees;</u> or (ii) not less than 18 per cent, <u>where the value of international transaction exceeds a sum of one hundred crore rupees but does not exceed a sum of two hundred crore rupees.</u>
2.	Provision of information technology enabled services referred to in item (ii) of rule 10TC.	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is - (i) not less than 17 per cent, <u>where the aggregate value of such transactions entered into during the previous year does not exceed a sum of one hundred crore rupees;</u> or (ii) not less than 18 per cent, <u>where the aggregate value of such transactions entered into during the previous year exceeds a sum of one hundred crore rupees but does not exceed a sum of two hundred crore rupees.</u>
3.	Provision of knowledge process outsourcing services referred to in item (iii) of rule 10TC.	The value of international transaction does not exceed a sum of <u>two hundred crore rupees</u> and the operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is - (i) not less than 24 per cent. and the Employee Cost in relation to the Operating Expense is at least sixty per cent. (ii) not less than 21 per cent. and the Employee Cost in relation to the Operating Expense is forty per cent. or more but less than sixty per cent. or (iii) not less than 18 per cent and the Employee Cost in relation to the Operating Expense does not exceed forty per cent.
4.	Advancing of intra-group loans referred to in item (iv) of rule 10TC where the amount of loan is denominated in Indian Rupees (INR) .	The interest rate declared in relation to the eligible international transaction is not less than the one-year marginal cost of funds lending rate of State Bank of India as on 1st April of the relevant previous year plus,- (i) 175 basis points, where the associated enterprise has <u>CRISIL credit rating between AAA to A or its equivalent;</u> (ii) 325 basis points, where the associated enterprise has <u>CRISIL credit rating of BBB-, BBB or BBB+ or its equivalent;</u> (iii) 475 basis points, where the associated enterprise has <u>CRISIL credit rating between BB to B or its equivalent;</u>

		(iv) 625 basis points, where the associated enterprise has <u>CRISIL credit rating between C to D or its equivalent</u>; or (v) 425 basis points, <u>where credit rating of the associated enterprise is not available</u> and the amount of loan advanced to the associated enterprise including loans to all associated enterprises in Indian Rupees does not exceed a sum of one hundred crore rupees in the aggregate as on 31st March of the relevant previous year.
5.	Advancing of intra-group loans referred to in item (iv) of rule 10TC where the amount of loan is denominated in foreign currency.	The interest rate declared in relation to the eligible international transaction is not less than the six-month London Inter-Bank Offer Rate of the relevant foreign currency as on 30th September of the relevant previous year plus, - (i) 150 basis points, where the associated enterprise has <u>CRISIL credit rating between AAA to A or its equivalent</u>; (ii) 300 basis points, where the associated enterprise has <u>CRISIL credit rating of BBB-, BBB or BBB+ or its equivalent</u>; (iii) 450 basis points, where the associated enterprise has <u>CRISIL credit rating between BB to B or its equivalent</u>; (iv) 600 basis points, where the associated enterprise has <u>CRISIL credit rating between C to D or its equivalent</u>; or (v) 400 basis points, <u>where credit rating of the associated enterprise is not available</u> and the amount of loan advanced to the associated enterprise including loans to all associated enterprises does not exceed a sum equivalent to one hundred crore Indian rupees in the aggregate as on 31st March of the relevant previous year.
6.	Providing corporate guarantee referred to in sub-item (a) or sub-item (b) of item (v) of rule 10TC.	The commission or fee declared in relation to the eligible international transaction is at the rate not less than one per cent per annum on the amount guaranteed.
7.	Provision of contract research and development services wholly or partly relating to software development referred to in item (vi) of rule 10TC.	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is not less than 24 per cent , <u>where the value of the international transaction does not exceed a sum of two hundred crore rupees.</u>
8.	Provision of contract research and development services wholly or partly relating to generic pharmaceutical drugs referred to in item (vii) of rule 10TC.	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense incurred is not less than 24 per cent , <u>where the value of the international transaction does not exceed a sum of two hundred crore rupees.</u>
9.	Manufacture and export of core auto components referred to in item (viii) of rule 10TC.	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is not less than 12 per cent.

10.	Manufacture and export of non-core auto components referred to in item (ix) of rule 10TC.	The operating profit margin declared by the eligible assessee from the eligible international transaction in relation to operating expense is not less than 8.5 per cent.
11.	Receipt of low value-adding intra-group services in item (x) of rule 10TC.	The entire value of the international transaction, including a mark-up not exceeding 5 per cent., does not exceed a sum of ten crore rupees: Provided that the method of cost pooling, the exclusion of shareholder costs and duplicate costs from the cost pool and the reasonableness of the allocation keys used for allocation of costs to the assessee by the overseas associated enterprise, is certified by an accountant.

57.22 RELEVANT DEFINITIONS**Rule:- 10TA**

For the purposes of this rule and rule 10TB to rule 10TG,—

- (a) "accountant" means an accountant referred to in the Explanation below sub-section (2) of section 288 of the Act and includes any person recognised for undertaking cost certification by the Government of the country where the associated enterprise is registered or incorporated or any of its agencies, who fulfils the following conditions, namely:—
- (I) if he is a member or partner in any entity engaged in rendering accountancy or valuation services then,—
 - (i) the entity or its affiliates have presence in more than two countries; and
 - (ii) the annual receipt of the entity in the year preceding the year in which cost certification is undertaken exceeds ten crore rupees;
 - (II) if he is pursuing the profession of accountancy individually or is a valuer then,—
 - (i) his annual receipt in the year preceding the year in which cost certification is undertaken, from the exercise of profession, exceeds one crore rupees; and
 - (ii) he has professional experience of not less than ten years.]
- (aa) "contract research and development services wholly or partly relating to software development" means the following, namely:—
- (i) research and development producing new theorems and algorithms in the field of theoretical computer science;
 - (ii) development of information technology at the level of operating systems, programming languages, data management, communications software and software development tools;
 - (iii) development of Internet technology;
 - (iv) research into methods of designing, developing, deploying or maintaining software;
 - (v) software development that produces advances in generic approaches for capturing, transmitting, storing, retrieving, manipulating or displaying information;
 - (vi) experimental development aimed at filling technology knowledge gaps as necessary to develop a software programme or system;
 - (vii) research and development on software tools or technologies in specialised areas of computing (image processing, geographic data presentation, character recognition, artificial intelligence and such other areas);or

- (viii) upgradation of existing products where source code has been made available by the principal [except where the source code has been made available to carry out routine functions like debugging of the software];

(b) "core auto components" means,—

- (i) engine and engine parts, including piston and piston rings, engine valves and parts cooling systems and parts and power train components;
- (ii) transmission and steering parts, including gears, wheels, steering systems, axles and clutches;
- (iii) suspension and braking parts, including brake and brake assemblies, brake linings, shock absorbers and leaf springs;

(c) "corporate guarantee" means explicit corporate guarantee extended by a company to its wholly owned subsidiary being a non-resident in respect of any short-term or long-term borrowing.

Explanation.—For the purposes of this clause, explicit corporate guarantee does not include letter of comfort, implicit corporate guarantee, performance guarantee or any other guarantee of similar nature;

(ca) "employee cost" includes,—

- (i) salaries and wages;
- (ii) gratuities;
- (iii) contribution to Provident Fund and other funds;
- (iv) the value of perquisites as specified in clause (2) of section 17 of the Act;
- (v) employment related allowances, like medical allowance, dearness allowance, travel allowance and any other allowance;
- (vi) bonus or commission by whatever name called;
- (vii) lump sum payments received at the time of termination of service or superannuation or voluntary retirement, such as gratuity, severance pay, leave encashment, voluntary retrenchment benefits, commutation of pension and similar payments;
- (viii) expenses incurred on contractual employment of persons performing tasks similar to those performed by the regular employees;
- (ix) outsourcing expenses, to the extent of employee cost, wherever ascertainable, embedded in the total outsourcing expenses:
Provided that where the extent of employee cost embedded in the total outsourcing expenses is not ascertainable, eighty per cent of the total outsourcing expenses shall be deemed to be the employee cost embedded in the total outsourcing expenses;
- (x) recruitment expenses;
- (xi) relocation expenses;
- (xii) training expenses;
- (xiii) staff welfare expenses; and
- (xiv) any other expenses related to employees or the employment;

(d) "generic pharmaceutical drug" means a drug that is comparable to a drug already approved by the regulatory authority in dosage form, strength, route of administration, quality and performance characteristics, and intended use;

(e) "information technology enabled services" means the following business process outsourcing services provided mainly with the assistance or use of information technology, namely:—

- (i) back office operations;
- (ii) call centres or contact centre services;
- (iii) data processing and data mining;
- (iv) insurance claim processing;
- (v) legal databases;

- (vi) creation and maintenance of medical transcription excluding medical advice;
 - (vii) translation services;
 - (viii) payroll;
 - (ix) remote maintenance;
 - (x) revenue accounting;
 - (xi) support centres;
 - (xii) website services;
 - (xiii) data search integration and analysis;
 - (xiv) remote education excluding education content development; or
 - (xv) clinical database management services excluding clinical trials,
- but does not include any research and development services whether or not in the nature of contract research and development services;

- (f)** "intra-group loan" means loan advanced to wholly owned subsidiary being a non-resident, where the loan—
- (i) is sourced in Indian rupees;
 - (ii) is not advanced by an enterprise, being a financial company including a bank or a financial institution or an enterprise engaged in lending or borrowing in the normal course of business; and
 - (iii) does not include credit line or any other loan facility which has no fixed term for repayment;
- (g)** "knowledge process outsourcing services" means the following business process outsourcing services provided mainly with the assistance or use of information technology requiring application of knowledge and advanced analytical and technical skills, namely:—
- (i) geographic information system;
 - (ii) human resources services;
 - (iii) engineering and design services;
 - (iv) animation or content development and management;
 - (v) business analytics;
 - (vi) financial analytics; or
 - (vii) market research,
- but does not include any research and development services whether or not in the nature of contract research and development services;
- (ga)** "low value-adding intra-group services" means services that are performed by one or more members of a multinational enterprise group on behalf of one or more other members of the same multinational enterprise group and which,—
- (i) are in the nature of support services;
 - (ii) are not part of the core business of the multinational enterprise group, i.e., such services neither constitute the profit-earning activities nor contribute to the economically significant activities of the multinational enterprise group;
 - (iii) are not in the nature of shareholder services or duplicate services;
 - (iv) neither require the use of unique and valuable intangibles nor lead to the creation of unique and valuable intangibles;
 - (v) neither involve the assumption or control of significant risk by the service provider nor give rise to the creation of significant risk for the service provider; and
 - (vi) do not have reliable external comparable services that can be used for determining their arm's length price, but does not include the following services, namely:—
- (i) research and development services;
 - (ii) manufacturing and production services;
 - (iii) information technology (software development) services;

- (iv) knowledge process outsourcing services;
 - (v) business process outsourcing services;
 - (vi) purchasing activities of raw materials or other materials that are used in the manufacturing or production process;
 - (vii) sales, marketing and distribution activities;
 - (viii) financial transactions;
 - (ix) extraction, exploration, or processing of natural resources; and
 - (x) insurance and reinsurance;]
- (h) "non-core auto components" mean auto components other than core auto components;
- (i) "no tax or low tax country or territory" means a country or territory in which the maximum rate of income-tax is less than fifteen per cent;
- (j) "operating expense" means the costs incurred in the previous year by the assessee in relation to the international transaction during the course of its normal operations including [costs relating to Employee Stock Option Plan or similar stock-based compensation provided for by the associated enterprises of the assessee to the employees of the assessee, reimbursement to associated enterprises of expenses incurred by the associated enterprises on behalf of the assessee, amounts recovered from associated enterprises on account of expenses incurred by the assessee on behalf of those associated enterprises and which relate to normal operations of the assessee and] depreciation and amortisation expenses relating to the assets used by the assessee, but not including the following, namely:—
- (i) interest expense;
 - (ii) provision for unascertained liabilities;
 - (iii) pre-operating expenses;
 - (iv) loss arising on account of foreign currency fluctuations;
 - (v) extraordinary expenses;
 - (vi) loss on transfer of assets or investments;
 - (vii) expense on account of income-tax; and
 - (viii) other expenses not relating to normal operations of the assessee:
- Provided** that reimbursement to associated enterprises of expenses incurred by the associated enterprises on behalf of the assessee shall be at cost:
- Provided further** that amounts recovered from associated enterprises on account of expenses incurred by the assessee on behalf of the associated enterprises and which relate to normal operations of the assessee shall be at cost;
- (k) "operating revenue" means the revenue earned by the assessee in the previous year in relation to the international transaction during the course of its normal operations [including costs relating to Employee Stock Option Plan or similar stock-based compensation provided for by the associated enterprises of the assessee to the employees of the assessee] but not including the following, namely:—
- (i) interest income;
 - (ii) income arising on account of foreign currency fluctuations;
 - (iii) income on transfer of assets or investments;
 - (iv) refunds relating to income-tax;
 - (v) provisions written back;
 - (vi) extraordinary incomes; and
 - (vii) other incomes not relating to normal operations of the assessee.
- (l) "operating profit margin" in relation to operating expense means the ratio of operating profit, being the operating revenue in excess of operating expense, to the operating expense expressed in terms of percentage;

(la) "relevant previous year" means the previous year relevant to the assessment year in which the option for safe harbour is validly exercised;

(m) "software development services" means,—

- (i) business application software and information system development using known methods and existing software tools;
- (ii) support for existing systems;
- (iii) converting or translating computer languages;
- (iv) adding user functionality to application programmes;
- (v) debugging of systems;
- (vi) adaptation of existing software; or
- (vii) preparation of user documentation,

but does not include any research and development services whether or not in the nature of contract research and development services.

Practical 15

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 (Rs.in crore)	Declared Operating Margin (Rs.in crore)	Operating Expense (Rs.in crore)
(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	12	75
(2)	B Ltd., an Indian company	Provision of data processing services with the use of information technology to Y Inc., its foreign subsidiary	180	30	150
(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	30	150
(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	9	30

(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	1	10
(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	1	10

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

- (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% (*i.e.*, $\frac{12}{75} \times 100$), 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 A Ltd.

- (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% (*i.e.*, $\frac{30}{150} \times 100$), 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% (*i.e.*, $\frac{30}{150} \times 100$), 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 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% (*i.e.*, $\frac{9}{30} \times 100$), 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% (*i.e.*, $\frac{1}{10} \times 100$), 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% (*i.e.*, $\frac{1}{10} \times 100$), the same is in 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.

Readers Note:

UNIT E – ADVANCE PRICING AGREEMENTS

57.23 ADVANCE PRICING AGREEMENT (APA)

Section:- 92CC, 92CD and Notification No:- 36/2012 dated 30-08-2012

- (1) Advance Pricing Agreement is an agreement between a taxpayer and a taxing authority on an appropriate transfer pricing methodology for a set of transactions over a fixed period of time in future. The APA offers better assurance on transfer pricing methods and are conducive in providing certainty and unanimity of approach.
- (2) Types of APA-
 - (a) Unilateral APAs - Unilateral APA is an arrangement between the tax payer and the Indian tax administration (CBDT)
 - (b) Bi-lateral/ multilateral APAs- Bilateral / multilateral APA involves not only the taxpayer and the Indian tax administration but also the taxpayer's affiliates (with whom he transacts) and their tax administration.
- (3) Sections 92CC and 92CD have been inserted by the Finance Act, 2012 with effect from July 1, 2012 to provide a framework for advance pricing agreement under the Act.

Consider the following FAQ on APA.

Question 16

What is Advance Pricing Agreement (APA)?

Answer

Advance Pricing Agreement (APA) is an agreement between a taxpayer and a taxing authority on an appropriate transfer pricing methodology for a set of transactions over a fixed period of time in future.

Readers Note:

Question 17

State the purpose of APA (Advance Pricing Agreement)?

Answer

APA shall include determination of the arm's length price or specify the manner in which arm's length price shall be determined, in relation to an international transactions to be entered into, by that person.

Readers Note:

Question 18

Who can apply for advance pricing agreement and state the time limit for its withdrawal?

Answer

Any person who has undertaken an international transaction or who is contemplating to undertake an international transaction is eligible to apply for Advance Pricing Agreement (APA). The applicant may withdraw the application for agreement in Form No. 3CEE at any time before the finalisation of the terms of the agreement. The fee paid shall not be refunded on withdrawal of application by the applicant.

Readers Note:

Question 19

What is the maximum period for which advance pricing agreement shall remain valid?

Answer

An advance pricing agreement shall remain valid for such period not exceeding 5 consecutive previous years as may be specified in the agreement

Readers Note:

Question 20

Shall APA be made applicable to the international transactions carried out in previous year(s) prior to the date of application?

Answer

With effect from 1st October, 2014, as per provisions of section 92CC (9A), the APA may, subject to such prescribed conditions, procedure and manner, provide for determining the ALP or for specifying the manner in which ALP is to be determined in relation to an international transaction entered into by a person during any period not exceeding four previous years preceding the first of the previous years for which the APA applies in respect of the international transaction to be undertaken.

E.g. If ABCD Ltd. has entered into an APA for a period of five years starting from previous year 2014-15, then subject to prescribed conditions, it can avail benefit of APA for the following financial years

Previous Years for which benefit available	Comment
2010-11	Preceding four previous years for which Roll Back Provision is applicable
2011-12	
2012-13	
2013-14	
2014-15 (Year in respect of which APA was entered)	Five consecutive Previous years for which APA has been entered into
2015-16	
2016-17	
2017-18	
2018-19	

Readers Note:

Question 21

How determination of ALP shall be made when taxpayer has entered into APA?

Answer

The manner of determination of arm's length price in a case where APA has been entered into, shall be by any method including those already provided in section 92C(1), with necessary adjustments or variations mentioned in APA.

Readers Note:

Question 22

Discuss the effectiveness of APA.

Answer

The APA shall be binding only on the person and the Commissioner (including income-tax authorities subordinate to him) in respect of the transaction in relation to which the agreement has been entered into. The APA shall not be binding if there is any change, in law, or facts having bearing on such APA.

Readers Note:

Question 23

Under what circumstance may, an advance pricing agreement, be declared to be void ab initio?

Answer

An advance pricing agreement can be declared by the CBDT as void ab initio with the approval of the Central Government, if it has been obtained by fraud or misrepresentation of facts.

Readers Note:

Question 24

In case an advance pricing agreement is entered into, does it have any effect on the return of income of the assessee?

Answer

As per section 92CD, where any person has entered into advance pricing agreement, and he has already furnished return of income under section 139 for any assessment year to which such agreement applies, such person shall furnish a modified return of income within a period of 3 months from the end of the month in which the said agreement was entered into in accordance with and limited to the agreement.

Readers Note:

Question 25

Narrate the procedures relating to pre-filing consultation of advance pricing agreement.

Answer

Every person proposing to enter into APA must file an application in writing making a request for pre-filing consultation. On the receipt of request in Form No.3CEC, the team shall hold consultation with the person referred to in rule 10G (i.e. a person who has undertaken or contemplating to undertake international transaction).

The competent authority in India or his representative shall be associated in pre-filing consultation involving bilateral or multilateral agreement.

The pre-filing consultation shall include - (a) determining the scope of agreement; (b) identify transfer pricing issues; (c) determine the suitability of international transaction for the agreement; and (d) discuss the broad terms of the agreement.

The pre-consultation agreement will not bind the Board or the person to enter into an agreement or initiate the agreement process. It shall not be deemed to mean that the person has applied for entering into an agreement.

Readers Note:

Question 26

What are the terms of APA?

Answer

Terms of APA include –

- (i) the international transactions covered by the agreement;
- (ii) the agreed transfer pricing methodology, if any;
- (iii) determination of arm's length price, if any;
- (iv) definition of any relevant term to be used in item (ii) or (iii);
- (v) critical assumptions i.e. the factors and assumptions that are so critical and significant that neither party entering into an agreement will continue to be bound by the agreement, if any of the factors or assumptions is changed ;

Readers Note:

Question 27

Narrate the procedure for furnishing Annual Compliance Report by the assessee, where advance pricing agreement has been entered into.

Answer

The assessee shall furnish an annual compliance report in quadruplicate to DGIT (International Taxation) for each year covered in the agreement. Annual compliance report shall be furnished within 30 days of the due date for filing return of income for that year or within 90 days of entering into an agreement, whichever is later.

The DGIT (International Taxation) shall send one copy of annual compliance report to the competent authority, one copy to Commissioner of Income Tax having jurisdiction of the assessee and one copy to the Transfer Pricing Officer having jurisdiction over the assessee.

Readers Note:

Question 28

Write a note on Compliance Audit of Advance Pricing Agreement.

Answer

Compliance Audit of Advance Pricing Agreement (Rule 10P):

- (1) The Transfer Pricing Officer having the jurisdiction over the assessee shall carry out the compliance audit of the agreement for each of the year covered in the agreement.
- (2) For the purposes of sub-rule(1), the Transfer Pricing Officer may require –
 - (i) the assessee to substantiate compliance with the terms of the agreement, including satisfaction of the critical assumptions, correctness of the supporting data or information and consistency of the application of the transfer pricing method;
 - (ii) the assessee to submit any information, or document, to establish that the terms of the agreement has been complied with.
- (3) The Transfer Pricing Officer shall submit the compliance audit report, for each year covered in the agreement, to the Director General of Income Tax (International Taxation) in case of unilateral agreement and to the competent authority in India, in case of bilateral or multilateral agreement, mentioning therein his findings as regards compliance by the assessee with terms of the agreement.
- (4) The Director General of Income Tax (International Taxation) shall forward the report to the Board in a case where there is finding of failure on part of assessee to comply with terms of agreement and cancellation of the agreement is required.
- (5) The compliance audit report shall be furnished by the Transfer Pricing Officer within six months from the end of the month in which the Annual Compliance Report referred to in rule 10 O is received by the Transfer Pricing Officer.

- (6) The regular audit of the covered transactions shall not be undertaken by the Transfer Pricing Officer if an agreement has been entered into under rule 10L except where the agreement has been cancelled under rule 10R.

Readers Note:

Question 29

Can the application for advance pricing agreement be amended? If so, state the conditions.

Answer

Yes. The applicant may request in writing for an amendment to the application at any stage before the finalization of the terms of the agreement.

The DGIT for unilateral agreement or the competent authority in India for bilateral or multilateral agreement may allow the amendment if it does not have the effect of altering the nature of application originally filed.

An amendment is possible only if it is accompanied by the additional fee, if any, necessitated by such amendment in accordance with rule 10 - I.

Readers Note:

Question 30

State the reasons for cancellation of advance pricing agreement.

Answer

An agreement shall be cancelled by the Board for any of the following reasons:

- (i) the compliance audit has resulted in the finding of failure on the part of the assessee to comply with the terms of the agreement;
- (ii) the assessee has failed to file the annual compliance report in time;
- (iii) the annual compliance report furnished by the assessee contains material errors; or
- (iv) the assessee is not in agreement with the revision proposed in the agreement.

Readers Note:

57.24 | NOTIFICATION – RULES FOR ROLLBACK OF APA – AN OVERVIEW

Notification No:- 23/2015 dated 14-03-2015

As discussed earlier, the roll back provision was brought into the Act vide Finance (No. 2) Act 2014, with effect from 1 October, 2014.

The Board has announced detailed rules explaining the roll back provisions and the procedure for giving effect to them. Apart from that, the Board has made another key amendment, wherein pre-filing consultation has been made optional for the taxpayer. Following are the key observation of these Rules.

- Form 3CEDA for the relevant roll back years have been filed before due date.
- Roll back application should cover all the roll back years (i.e., the years falling with the block of four years) in which the international transaction has taken place.
- Roll back provisions shall not be provided, in respect of an international transaction, if the Income-tax Appellate Tribunal has passed an order disposing off an appeal relating to determination of ALP of the international transaction, at any time before signing of the APA agreement; or application of roll back has the effect of reducing total income or increasing the total loss.
- The manner of determining ALP in the roll back years with respect to any particular international transaction will be same as the manner agreed in the regular APA.

57.25 | CBDT CIRCULAR CLARIFY CERTAIN ISSUES ARISING OUT OF THE ROLL BACK RULES**Circular No. 10/2015 dated 10.06.2015****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 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).

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 subrules (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. 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?

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.

UNIT F – CONCEPT OF SECONDARY ADJUSTMENT AND THIN CAPITALISATION

57.26 | SECONDARY ADJUSTMENT IN CERTAIN CASES

Section:- 92CE – Effective from A.Y. 2018-19

(1) Meaning

"**primary adjustment**" to a transfer price, means the determination of transfer price in accordance with the arm's length principle resulting in an increase in the total income or reduction in the loss, as the case may be, of the assessee;

"secondary adjustment" means an adjustment in the books of account of the assessee and its associated enterprise to reflect that the actual allocation of profits between the assessee and its associated enterprise are consistent with the transfer price determined as a result of primary adjustment, thereby removing the imbalance between cash account and actual profit of the assessee.

(2) Applicability of secondary adjustment :- [Section 92CE(1)]

Where a primary adjustment to transfer price,—

- (i) has been made suo motu by the assessee in his return of income;
 - (ii) made by the Assessing Officer has been accepted by the assessee;
 - (iii) is determined by an advance pricing agreement entered into by the assessee under section 92CC;
 - (iv) is made as per the safe harbour rules framed under section 92CB; or
 - (v) is arising as a result of resolution of an assessment by way of the mutual agreement procedure under an agreement entered into under section 90 or section 90A for avoidance of double taxation,
- the assessee shall make a secondary adjustment:

(3) When Secondary adjustment not required [Proviso to section 92CE(1)]

Secondary adjustment not required if,—

- (i) the amount of primary adjustment made in any previous year does not exceed one crore rupees; and
- (ii) the primary adjustment is made in respect of an assessment year commencing on or before the 1st day of April, 2016.

(4) Quantification of Secondary Adjustment [Section 92 CE(2)]

Where, as a result of primary adjustment to the transfer price, there is an increase in the total income or reduction in the loss, as the case may be, of the assessee, the excess money which is available with its associated enterprise, if not repatriated to India within the time as may be prescribed, shall be deemed to be an advance made by the assessee to such associated enterprise and the interest on such advance, shall be computed in such manner as may be prescribed. (Notification 52 / 2017 dated 15-06-2017 tabulated below)

Type of primary adjustment	Time limit for repatriation	Applicable interest rate for delayed receipts	
		Transaction in INR	Transaction in Foreign currency
Adjustment made by the Indian Tax Authority and accepted by the taxpayer	On or before 90 days from the date of relevant order	One year marginal cost of fund lending rate of State Bank of India as of 1 April of the relevant FY plus 325 basis points	Six month London Interbank Offered rate as of 30 September of the relevant FY plus 300 basis points
Suo-moto adjustment by the taxpayer	On or before 90 days from the due date of filing return of income		
Adjustment pursuant to APA, Safe Harbour or MAP	(or modified return as may be applicable in case of an APA)		

For the purpose of this section, "excess money" means the difference between the arm's length price determined in primary adjustment and the price at which the international transaction has actually been undertaken.

Practical 31

Infyvim Private Limited (IPL) is an Indian company in which Moon Inc.(Foreign Company) holds 26% equity. IPL provides following information:

- (a) IPL provides system support services to Moon Inc.
- (b) During the year 2017-18, IPL provided services to the tune of Rs. 12 crore.
- (c) However, assessing officer determines arm's length price at Rs.15.25 Crore and the same is accepted by IPL.

You are required to discuss the concept of “Primary adjustment” and “Secondary adjustment” assuming that excess money is not repatriated to India by Moon Inc.

Solution

The addition made by assessing officer to the total income of IPL is Rs. 3.25 crore – It is called primary adjustment. Since this excess Rs. 3.25 crore has not been repatriated by Moon Inc. to IPL, it would be termed as deemed advance (a secondary adjustment) made by IPL to Moon Inc. Thereafter, interest shall be charged on such deemed advance in such manner as may be prescribed.

Reader’s Note:

57.27 | LIMITATION ON INTEREST DEDUCTIBLE**Section:- 94B – Effective from A.Y. 2018-19****(1) Preference of debt over equity as a measure to finance businesses**

Debt and equity are the instruments through which a company is generally financed or capitalized. The manner in which a company is capitalized has a major impact on the amount of taxable profit as the tax laws of countries generally provide for a deduction in respect of interest paid or payable while arriving at the taxable profit. However, the dividend paid on equity contribution is not deductible. Therefore, the higher the level of debt in a company, and thus, the amount of interest it pays, the lower will be its taxable income. Due to this reason, debt is considered a more tax efficient method of finance than equity. Multinational groups are often able to structure their financing arrangements to maximize tax benefits.

(2) Tax Rules to prevent shifting of profits through excessive interest payments

In order to address this issue, tax rules are in place in each country to fix a ceiling limit on the amount of interest deductible in computing a company's profit for tax purposes. Such rules are designed to counter cross-border shifting of profit through excessive interest payments, with the objective of protecting a country's tax base.

(3) Relevant Action Plan of BEPS

Under the initiative of the G-20 countries, the Organization for Economic Co-operation and Development (OECD) in its Base Erosion and Profit Shifting (BEPS) project had taken up the issue of base erosion and profit shifting by way of excess interest deductions by the MNEs in Action Plan 4 and recommended certain measures in its final report.

(4) Insertion of provision in the Income-tax Act, 1961 in line with BEPS Action Plan 4

Section 94B has, accordingly, been inserted in the Income-tax Act, 1961, in line with the recommendations of OECD BEPS Action Plan 4, to provide that interest expenses claimed by an entity to its associated enterprises shall not be deductible in computation of income under the “Profits and gains of business or profession” to the extent that it arises from excess interest

Sub - Section (1):- Excess Interest shall not be deductible

Notwithstanding anything contained in this Act, where an Indian company, or a permanent establishment of a foreign company in India,
being the borrower,
incurs any expenditure by way of interest or of similar nature exceeding one crore rupees which is deductible in computing income chargeable under the head "Profits and gains of business or profession" in respect of any debt issued by a non-resident, being an associated enterprise of such borrower,
the interest shall not be deductible in computation of income under the said head to the extent that it arises from excess interest, as specified in sub-section (2) :

Sub - Section (2):- Determination of Excess Interest

For the purposes of sub-section (1), the excess interest shall mean

- (a) an amount of total interest paid or payable in excess of thirty per cent of earnings before interest, taxes, depreciation and amortisation of the borrower in the previous year or
- (b) interest paid or payable to associated enterprises for that previous year, whichever is less.

Sub - Section (3):- Non- applicability of section 94B(1)

Nothing contained in sub-section (1) shall apply to an Indian company or a permanent establishment of a foreign company which is engaged in the business of banking or insurance.

Sub - Section (4):- Carry forward of the excess interest

Where for any assessment year,
the interest expenditure is not wholly deducted against income under the head "PGBP",
so much of the interest expenditure as has not been so deducted,
shall be carried forward to the following assessment year or assessment years,
and

it shall be allowed as a deduction against the profits and gains, if any, of any business or profession carried on by it and assessable for that assessment year to the extent of maximum allowable interest expenditure in accordance with sub-section (2):

Provided that no interest expenditure shall be carried forward under this sub-section for more than eight assessment years immediately succeeding the assessment year for which the excess interest expenditure was first computed.

Sub - Section (5):- Meaning of certain terms

"Debt" means any loan, financial instrument, finance lease, financial derivative, or any arrangement that gives rise to interest, discounts or other finance charges that are deductible in the computation of income chargeable under the head "Profits and gains of business or profession";

Deemed debt as per proviso to section 94B(1) : Where the debt is issued by a lender which is not associated but an associated enterprise either provides an implicit or explicit guarantee to such lender or deposits a corresponding and matching amount of funds with the lender, such debt shall be deemed to have been issued by an associated enterprise.

"permanent establishment" includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.

Practical 32

TATU MFG Ltd. is an Indian subsidiary of JAGUAR Limited, UK based Company. TATU MFG Ltd. has borrowed from JAGUAR Limited. From the following information, find out disallowance to be made under section 94B of the Income Tax Act for the assessment years 2018-19.

Particulars	Rs. (in crore)
Earnings before interest, taxes, depreciation and amortisation	20
Interest to associated enterprise	5
Interest to others	2

Solution**Computation of Excess Interest (disallowance) under section 94 B of the Act for the A.Y. 2018-19**

Sr. No.	Lower of	Amount (Rs. in crore)
(a)	Total interest paid or payable in excess of thirty per cent of earnings before interest, taxes, depreciation and amortisation of the borrower in the previous year (Refer working Note)	1
(b)	Interest paid or payable to associated enterprises for that previous year	5
(c)	Excess Interest to be disallowed [Lower of (a) or (b)]	1

Working Note:

Sr. No.	Particulars	Amount (Rs. in crore)
(a)	Total Interest (i.e. Interest to associated enterprise plus Interest to others)	7
(b)	30% of Earnings before interest, taxes, depreciation and amortization	6
(c)	Total interest paid or payable in excess of thirty per cent of earnings before interest, taxes, depreciation and amortisation of the borrower in the previous year (a-b)	1

Note:- Such excess interest of Rs. 1 Cr. shall be carried forward to the following assessment year or assessment years (maximum 8 years), and it shall be allowed as a deduction against the profits and gains, if any, of any business or profession carried on by it and assessable for that assessment year to the extent of maximum allowable interest expenditure in accordance with section 94B (2).

Reader's Note:**UNIT G – COUNTRY BY COUNTRY REPORTING**
57.28 FURNISHING OF REPORT IN RESPECT OF INTERNATIONAL GROUP IN LINE WITH BEPS ACTION PLAN – COUNTRY BY COUNTRY REPORT AND MASTER FILE
Section:-**(1) Requirements as per OECD report on Action 13 of BEPS Action Plan**

The report provides for:

- (a) revised standards for transfer pricing documentation; and
- (b) a template for country-by-country reporting of income, earnings, taxes paid and certain measure of economic activity.

(2) Three-tier structure mandated by BEPS

The BEPS report recommends that countries adopt a standardised approach to transfer pricing documentation; it mandates the following three-tier structure:-

Sr. No.	Document	Information
(a)	Master File	Standardised information relevant for all multinational enterprises (MNE) group members
(b)	Local File	Specific reference to material transactions of the local taxpayer
(c)	Country – by – Country report	Information relating to the global allocation of the MNE's income and taxes paid; and Indicators of the location of economic activity within the MNE group.

(3) Advantages of the three tier structure [as per BEPS Report]:

- (a) Taxpayers will be required to articulate consistent transfer pricing positions;
- (b) Tax administrations would get useful information to assess transfer pricing risks;
- (c) Tax administrations would be able to make determinations about where their resources can most effectively be deployed, and, in the event audits are called for, provide information to commence and target audit enquiries.

57.29 FURNISHING OF REPORT IN RESPECT OF INTERNATIONAL GROUP in INDIA**Section:- 286**

- (1)** Every constituent entity resident in India, shall, if it is constituent of an international group, the parent entity of which is not resident in India, notify the prescribed income-tax authority (herein referred to as prescribed authority) in the form and manner, on or before such date, as may be prescribed,—
- (a) whether it is the alternate reporting entity of the international group; or
 - (b) the details of the parent entity or the alternate reporting entity, if any, of the international group, and the country or territory of which the said entities are resident.
- (2)** Every parent entity or the alternate reporting entity, resident in India, shall, for every reporting accounting year, in respect of the international group of which it is a constituent, furnish a report, to the prescribed authority ~~on or before the due date specified under sub-section (1) of section 139,~~ within a period of twelve months from the end of the said reporting accounting year **[Substituted by Finance Act, 2018 w.r.e.f. A.Y. 2017-18]** for furnishing the return of income for the relevant accounting year, in the form and manner as may be prescribed.
- (3)** For the purposes of sub-section (2) **and sub-section (4) [Inserted by Finance Act, 2018 w.r.e.f. A.Y. 2017-18]**, the report in respect of an international group shall include,—
- (a) the aggregate information in respect of the amount of revenue, profit or loss before income-tax, amount of income-tax paid, amount of income-tax accrued, stated capital, accumulated earnings, number of employees and tangible assets not being cash or cash equivalents, with regard to each country or territory in which the group operates;
 - (b) the details of each constituent entity of the group including the country or territory in which such constituent entity is incorporated or organised or established and the country or territory where it is resident;
 - (c) the nature and details of the main business activity or activities of each constituent entity; and
 - (d) any other information as may be prescribed.
- (4)** A constituent entity of an international group, resident in India, other than the entity referred to in sub-section (2), shall furnish the report referred to in the said sub-section, in respect of the international group for a reporting accounting year within the period as may be prescribed **[Inserted by Finance Act, 2018 w.r.e.f. A.Y. 2017-18]**, if the parent entity is resident of a country or territory,—
- (a) Where the parent entity is not obliged to file the report of nature referred to in sub-section (2); **[Inserted by Finance Act, 2018 w.r.e.f. A.Y. 2017-18]**
 - (b) with which India does not have an agreement providing for exchange of the report of the nature referred to in sub-section (2); or

- (c) there has been a systemic failure of the country or territory and the said failure has been intimated by the prescribed authority to such constituent entity:

Provided that where there are more than one such constituent entities of the group, resident in India, the report shall be furnished by any one constituent entity, if,—

- (a) the international group has designated such entity to furnish the report in accordance with the provisions of sub-section (2) on behalf of all the constituent entities resident in India; and
- (b) the information has been conveyed in writing on behalf of the group to the prescribed authority.

- (5) Nothing contained in sub-section (4) shall apply, if, an alternate reporting entity of the international group has furnished a report of the nature referred to in sub-section (2), with the tax authority of the country or territory in which such entity is resident, on or before the date specified in the said sub-section **by that country or territory [Substituted by Finance Act, 2018 w.r.e.f. A.Y. 2017-18]** and the following conditions are satisfied, namely:—

- (a) the report is required to be furnished under the law for the time being in force in the said country or territory;
- (b) the said country or territory has entered into an agreement with India providing for exchange of the said report;
- (c) the prescribed authority has not conveyed any systemic failure in respect of the said country or territory to any constituent entity of the group that is resident in India;
- (d) the said country or territory has been informed in writing by the constituent entity that it is the alternate reporting entity on behalf of the international group; and
- (e) the prescribed authority has been informed by the entity referred to in sub-section (4) in accordance with sub-section (1).

- (6) The prescribed authority may, for the purposes of determining the accuracy of the report furnished by any reporting entity, by issue of a notice in writing, require the entity to produce such information and document as may be specified in the notice within thirty days of the date of receipt of the notice:

Provided that the prescribed authority may, on an application made by such entity, extend the period of thirty days by a further period not exceeding thirty days.

- (7) The provisions of this section shall not apply in respect of an international group for an accounting year, if the total consolidated group revenue, as reflected in the consolidated financial statement for the accounting year preceding such accounting year does not exceed the amount, as may be prescribed.

- (8) The provisions of this section shall be applied in accordance with such guidelines and subject to such conditions, as may be prescribed.

57.30 | PENALTIES FOR NOT COMPLYING CBC REPORTING

Section:- 271 GB

Section	Nature of default	Penalty leviable	Competent IT Authority to levy penalty
271GB(1)	Failure to furnish report u/s 286(2)	Rs. 5,000 per day upto 30 days and Rs. 15,000 per day beyond 30 days	Prescribed Income-tax Authority

271GB(2)	Failure to produce the information and documents within the period allowed u/s 271GB(6)	Rs. 5,000 for every day during which the failure continues.	Prescribed Income-tax Authority
271GB(3)	Failure to furnish report or failure to produce information/documents under section 286 even after serving order u/s 271GB(1) or 271GB(2)	Rs.50,000 for every day for which such failure continues beginning from the date of serving such order.	Prescribed Income-tax Authority
271GB(4)	Failure to inform about inaccuracy in report furnish u/s 286(2) Or furnishing of inaccurate information or document in response to notice issued u/s 286(6).	Rs. 5,00,000	Prescribed Income-tax Authority

UNIT H – PENALTIES

57.31 VARIOUS PENALTIES

Section:- 271AA(1), 271BA and 271G

Section	Nature Of Default	Penalty Leviable
271AA(1)	(1) Failure to keep and maintain information and documents required by section 92D(1) or 92D(2) (2) Failure to report such transaction (3) Maintaining or furnishing incorrect information or document	2% of value of each international transaction / or specified domestic transaction entered into
271BA	Failure to furnish a report from an accountant as required by section 92E	Rs. 1,00,000
271G	Failure to furnish any information or document as required by section 92D(3)	2% of the value of the international transaction / specified domestic transaction for each failure

Practical 33

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.

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.

Solution

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.

Readers Note:

UNIT I – NOTIFIED JURISDICTIONAL AREA

57.32	SPECIAL MEASURES IN RESPECT OF TRANSACTIONS WITH PERSONS LOCATED IN NOTIFIED JURISDICTIONAL AREA.

Section:- 94A

Section 94A (1): The Central Government may, having regard to the lack of effective exchange of information with any country or territory outside India, specify by notification in the Official Gazette such country or territory as a notified jurisdictional area in relation to transactions entered into by any assessee.

Section 94A (2): Notwithstanding anything to the contrary contained in this Act, if an assessee enters into a transaction where one of the parties to the transaction is a person located in a notified jurisdictional area, then—

- (i) **all the parties** to the transaction **shall be deemed to be associated enterprises** within the meaning of section 92A;
- (ii) **any transaction** in the nature of purchase, sale or lease of tangible or intangible property or provision of service or lending or borrowing money or any other transaction having a bearing on the profits, income, losses or assets of the assessee including a mutual agreement or arrangement for allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided by or to the assessee **shall be deemed to be an international transaction** within the meaning of section 92B,

and the **provisions of sections 92, 92A, 92B, 92C [except the second proviso to sub-section (2)], 92CA, 92CB, 92D, 92E and 92F shall apply accordingly.**

Section 94A (3): Notwithstanding anything to the contrary contained in this Act, **no deduction,—**

- (a) in respect of any payment made to any financial institution located in a notified jurisdictional area shall be allowed under this Act, unless the assessee furnishes an authorisation in the prescribed form authorising the Board or any other income-tax authority acting on its behalf to seek relevant information from the said financial institution on behalf of such assessee; and
- (b) in respect of any other expenditure or allowance (including depreciation) arising from the transaction with a person located in a notified jurisdictional area shall be allowed under any other provision of this Act, unless the assessee maintains such other documents and furnishes such information as may be prescribed, in this behalf.

Section 94A (4): Notwithstanding anything to the contrary contained in this Act, where, in any previous year, the assessee has received or credited any sum from any person located in a notified jurisdictional area and the assessee does not offer any explanation about the source of the said sum in the hands of such person or in the hands of the beneficial owner (if such person is not the beneficial owner of the said sum) or the explanation offered by the assessee, in the opinion of the Assessing Officer, is not satisfactory, then, such sum shall be deemed to be the income of the assessee for that previous year.

Section 94A (5): Notwithstanding anything contained in any other provisions of this Act, where any person located in a notified jurisdictional area 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 provisions of this Act;
- (c) at the rate of thirty per cent.

Section 94A (6): In this section,—

- (i) “person located in a notified jurisdictional area” shall include,—
 - (a) a person who is resident of the notified jurisdictional area;
 - (b) a person, not being an individual, which is established in the notified jurisdictional area; or
 - (c) a permanent establishment of a person not falling in sub-clause (a) or sub-clause (b), in the notified jurisdictional area;
- (ii) “permanent establishment” shall have the same meaning as defined in clause (iia) of section 92F;
- (iii) “transaction” shall have the same meaning as defined in clause (v) of section 92F.

Practical 34

Mr. Robert, a non-resident has invested Rs. 6 crore in notified infrastructure debt fund and therefore he is in receipt of interest income Rs. 50 lakhs during the concerned previous year. Further, he incurred bank charges Rs. 12,000 for realizing such income. Assuming that Mr. Robert is a resident of a NJA, discuss the tax implications of this transaction under Income Tax Act, 1961.

Solution

As per section 115A of the Income Tax Act, 1961, gross interest income from a notified infrastructure debt fund shall be taxed at 5% (plus 3% EC). Therefore, the tax liability of Mr. Robert in respect of such income would be Rs. 2,57,500.

Generally, as per section 194LB, TDS shall be made @5% on interest paid by infrastructure debt fund.

However, since Robert is a resident of a NJA and therefore, considering the overriding effect of section 94 A (5), TDS shall be made at @30%.

Readers Note:

58 – TAXATION OF EQUALISATION LEVY

Practical 1

The contents of a business transaction done through e-commerce are not different from that of a business transaction carried out through traditional means. Which are the distinct means/methods of doing for e-business?

Solution

E-commerce is not the business transaction but it is a method or conducting business transaction. Following are the three means of doing business in e-commerce.

- (1) **Electronic Advertising:-** Advertising is done through website. Potential Customer accesses the website and obtains the information regarding the products. Thereafter, rest of transaction which lead to purchase of the product may be completed in the traditional way i.e. by giving the order in writing or by the way of telephone or email and making the payment by cheque and getting the goods through carrier.
- (2) **Electronic sales:-** In this system, the web site allows the potential customer to place an order on internet as well as facilitate the payment through credit cards or internet itself.
- (3) **Electronic Delivery:-** Now a days, Texts, visual material, audio material, computer software (relating to design, drawing, games etc.) are available in the digitized form. The potential buyer can place an order on the internet to purchase any of the above products available in digitized form, make the payment through credit cards on internet in the digitized form.

Readers Note:

Practical 2

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.

Solution

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

- (a) Transactions are completed in cyber-space;
- (b) absence of national boundaries;
- (c) no requirement of physical delivery (in certain cases).

All the above causing difficulty in implementing source rule of taxation.

Readers Note:

Practical 3

E-commerce transactions have replaced concepts generally associated with international transactions traditionally. Discuss briefly the issues involving such transactions.

Solution

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;
- (3) And thereby the difficulty in identifying Permanent Establishment.

Readers Note:

Practical 4

Nikanu Ltd. is an Indian Company involved in manufacturing and trading in cotton garments under the brand name “PCOTT”. In order to expand its exports sale, it launched a massive publicity campaign in overseas market. For the purpose of online advertising, it hired the Sky Inc., a New York based company which has no permanent establishment in India and paid Rs. 10 lakhs for its services in the concerned previous year.

Discuss the tax and TDS implications of such transaction both in the hands of Nikanu Ltd. and Sky Inc., respectively, if-

- (i) SKY Inc. has no permanent establishment in India
- (ii) SKY Inc. has a permanent establishment in India, and the service is effectively connected to the permanent establishment in India.

Solution**(i) Where SKY Inc. has no permanent establishment in India**

In the present case, equalisation levy @6% is chargeable on the amount of Rs.10,00,000 received by SKY Inc., a non-resident not having a PE in India from Nikanu Ltd., an Indian company. Accordingly, Nikanu Ltd. is required to deduct equalisation levy of Rs. 60,000 i.e., @6% of Rs. 10 lakhs, being the amount paid towards online advertisement services provided by SKY 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 SKY Inc. has permanent establishment in India and the service is effectively connected to the permanent establishment in India

Equalisation levy would not be attracted where the non-resident service provider (SKY Inc., in this case) has a permanent establishment in India and the service is effectively connected to the permanent establishment in India. Therefore, the Nikanu Ltd. is not required to deduct equalisation levy on Rs.10 lakhs, being the amount paid towards online advertisement services to SKY Inc, in this case.

However, tax has to be deducted by Nikanu Ltd. at the rates in force under section 195 in respect of such payment to SKY 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.

Readers Note:

PART - II

IMPORTANT CIRCULARS, NOTIFICATIONS

2 – INCOME WHICH DO NOT FORM PART OF TOTAL INCOME**2.1 CIRCULARS****1. Circular No. 4/2018, Dated 14-8-2018****Computation of admissible deduction u/s 10AA of the Income-tax Act, 1961**

The issue of whether freight, telecommunication charges and insurance expenses are to be excluded from both "export turnover" and "total turnover" while working out deduction admissible under section 10AA on the ground that they are attributable to delivery of articles or things outside India has been highly contentious. Similarly, the issue whether charges for rendering services outside India are to be excluded both from "export turnover" and "total turnover" while computing deduction admissible under section 10AA on the ground that such charges are relatable towards expenses incurred in convertible foreign exchange in rendering services outside India has also been highly contentious.

The controversy has been finally settled by the Hon'ble Supreme Court vide its judgment dated 24.4.2018 in the case of Commissioner of Income Tax, Central-III Vs. M/s HCL Technologies Ltd., in relation to section 10A.

The issue had been examined by CBDT and it is clarified, in line with the above decision of the Supreme Court, that freight, telecommunication charges and insurance expenses are to be excluded both from "export turnover" and "total turnover", while working out deduction admissible under section 10AA to the extent they are attributable to the delivery of articles or things outside India.

Similarly, expenses incurred in foreign exchange for rendering services outside India are to be excluded from both "export turnover" and "total turnover" while computing deduction admissible under section 10AA.

5 – PROFITS AND GAINS FROM BUSINESS OR PROFESSION**5.1 NOTIFICATIONS****1. Notification No. 42/2018, dated 30-08-2018]****Determining fair market value of inventory on the date of conversion into capital asset**

Section 28(via) has been inserted by the Finance Act, 2018 to provide that fair market value of the inventory on the date of its conversion or treatment as capital asset, determined in the prescribed manner, would be chargeable to tax as business income.

Accordingly, the CBDT, has vide this notification, inserted Rule 11UAB to prescribe the manner of determination of fair market value (FMV) of the inventory on the date of conversion.

Rule 11UAB. (1) For the purposes of clause (via) of section 28 of the Act, the fair market value of the inventory,—

- (i) being an immovable property, being land or building or both, shall be the value adopted or assessed or assessable by any authority of the Central Government or a State Government for the purpose of stamp duty in respect of such immovable property on the date on which the inventory is converted into, or treated, as a capital asset;
- (ii) being jewellery, archaeological collections, drawings, paintings, sculptures, any work of art, shares or securities referred to in rule 11UA, shall be the value determined in the manner provided in sub-rule (1) of rule 11UA and for this purpose the reference to the valuation date in the rule 11U and rule 11UA shall be the date on which the inventory is converted into, or treated, as a capital asset;
- (iii) being the property, other than those specified in clause (i) and clause (ii), the price that such property would ordinarily fetch on sale in the open market on the date on which the inventory is converted into, or treated, as a capital asset.

7 – INCOME FROM OTHER SOURCES

7.1 NOTIFICATIONS

1. Notification No. 24/2018, dated 24-05-2018

Exception notified for the purposes of clause (ii) of the proviso to section 56(2)(viib)

Where a company, other than a company in which public are substantially interested, issues shares at a premium to a person being a resident, section 56(2)(viib) brings to tax in the hands of such company, the difference between the aggregate consideration received for such shares as exceeds the fair market value of the shares under the head “Income from Other Sources”.

However, such provision would not be attracted where the consideration for issue of such shares is received by a company from a class or classes of persons as may be notified by the Central Government in this behalf.

Earlier the Central Government had, vide Notification No. 45/2016, dated 14.6.2016, notified classes of persons, i.e., a person defined under section 2(31) of the Income-tax Act, 1961, being a resident, who makes payment of an amount exceeding the face value of shares of the “startup” company, as consideration for issue of such shares.

In supersession of the above mentioned Notification, the Central Government has, vide this notification, notified that the provisions of section 56(2)(viib) shall not apply to consideration received by a company, being an eligible start-up for the purposes of deduction under section 80-IAC, for issue of shares that exceeds the face value of such shares, if the consideration has been received for issue of shares from an investor in accordance with the approval granted by the Inter-Ministerial Board of Certification under para 4(3)(i) of the notification number G.S.R. 364(E), dated 11th April, 2018 issued by the Department of Industrial Policy and Promotion.

As per para 4 of the notification number G.S.R. 364(E), dated 11th April, 2018 issued by the Department of Industrial Policy and Promotion, an eligible start-up for the purposes of deduction under section 80-IAC, has to make an application in Form-2 to the IMB provided following conditions are satisfied:

- (i) the aggregate amount of paid up share capital and share premium of the startup after the proposed issue of shares does not exceed ten crore rupees,
- (ii) the investor/ proposed investor, who proposed to subscribe to the issue of shares of the startup has,-
 - (a) the average returned income of twenty five lakh rupees or more for the preceding three financial years; or
 - (b) the net worth of two crore rupees or more as on the last date of the preceding financial year
- (iii) the startup has obtained a report from a merchant banker specifying the fair market value of shares in accordance with Rule 11UA of the Income-tax Rules, 1962.

Accordingly, vide this notification, the eligibility criteria for non-applicability of section 56(2)(viib) have been specified in relation to the recipient company rather than the class or classes of persons making payment for issue of shares to the company.

This notification shall be deemed to have come into effect from 11.04.2018.

21– APPEALS AND REVISIONS**21.1 CIRCULARS**

- 1. Circular No. 3/2018, Dated 11-7-2018 and F. No. 279/Misc. 142/2007-ITJ (Pt), Dated 20-8-2018**
Revision of monetary limits for filing of appeals by the Department before Income Tax Appellate Tribunal, High Courts and SLPs/appeals before Supreme Court -

Circular No. 21/2015 dated 10.12.2015 specified monetary limits and other conditions for filing departmental appeals (in Income-tax matters) before Income Tax Appellate Tribunal, High Courts and SLPs/ appeals before Supreme Court.

In supersession of the above Circular, it has been decided by the CBDT that departmental appeals may be filed on merits before Income Tax Appellate Tribunal and High Courts and SLPs/ appeals before Supreme Court keeping in view the monetary limits and conditions specified below.

Henceforth, appeals/ SLPs shall not be filed in cases where the tax effect does not exceed the monetary limits given hereunder:

Sr. No.	Appeals/ SLPs in Income-tax matters	Monetary Limit (Rs.)
1)	Before Appellate Tribunal	20,00,000
2)	Before High Court	50,00,000
3)	Before Supreme Court	1,00,00,000

Cases where adverse judgments should be contested on merits even if tax effect is less than the specified monetary limits

Adverse judgments relating to the issues enumerated hereunder should be contested on merits notwithstanding that the tax effect entailed is less than the monetary limits specified in para 3 thereof or there is no tax effect:

- Where the Constitutional validity of the provisions of an Act or Rule is under challenge, or
- Where Board's order, Notification, Instruction or Circular has been held to be illegal or ultra vires, or
- Where Revenue Audit objection in the case has been accepted by the Department, or
- Where addition relates to undisclosed foreign income/undisclosed foreign assets (including financial assets)/undisclosed foreign bank account.
- Where addition is based on information received from external sources in the nature of law enforcement agencies such as CBI/ED/DRI/SFIO/Directorate General of GST Intelligence (DGGI).
- Cases where prosecution has been filed by the Department and is pending in the Court.

27 – DEDUCTION, COLLECTION AND RECOVERY OF TAX**27.1 | NOTIFICATIONS****1. Notification No. 27 & 28/2018, dated 18-06-2018**

No tax is required to be deducted at source on interest payable on “Power Finance Corporation Limited 54EC Capital Gains Bond” and “Indian Railway Finance Corporation Limited 54EC Capital Gains Bond”

Section 193 (Interest on securities) provides that the person responsible for paying to a resident any income by way of interest on securities shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax @ 10%, being the rates in force on the amount of the interest payable.

As per clause (iib) of the proviso to section 193, no tax is required to be deducted at source from any interest payable on such debentures, issued by any institution or authority, or any public sector company, or any co-operative society (including a co-operative land mortgage bank or a co-operative land development bank), as the Central Government may, by notification in the Official Gazette, specify in this behalf.

Accordingly, the Central Government has, vide this notification, specified -

- (i) “Power Finance Corporation Limited 54EC Capital Gains Bond” issued by Power Finance Corporation Limited {PFCL} and
- (ii) “Indian Railway Finance Corporation Limited 54EC Capital Gains Bond” issued by Indian Railway Finance Corporation Limited {IRFCL}
- (iii) The benefit of this exemption would, however, be admissible in the case of transfer of such bonds by endorsement or delivery, only if the transferee informs PFCL/IRFCL by registered post within a period of sixty days of such transfer.

54– TAXATION OF NON-RESIDENT

54.1 NOTIFICATIONS

1. Notification No. 29/2018, dated 22-06-2018

Notification of exceptions, modifications and adaptations under Section 115JH for applicability of the provisions of the Income-tax Act on a foreign company said to be resident in India on account of PoEM.

With effect from 1.4.2017, Chapter XII-BC consisting of Section 115JH has been inserted by the Finance Act, 2016 to provide that where a foreign company is said to be resident in India in any previous year on account of Place of Effective Management (PoEM) and such foreign company has not been resident in India in any of the previous years preceding the said previous year, then, notwithstanding anything contained in this Act and subject to the conditions as may be notified by the Central Government in this behalf, the provisions of this Act relating to the computation of total income, treatment of unabsorbed depreciation, set off or carry forward and set off of losses, collection and recovery and special provisions relating to avoidance of tax shall apply with such exceptions, modifications and adaptations as may be specified in that notification for the said previous year.

Accordingly, the Central Government has, vide this Notification, specified the exceptions, modifications and adaptations subject to which, the provisions of the Act relating to computation of income, treatment of unabsorbed depreciation, set-off or carry forward and set off of losses, special provision relating to avoidance of tax and the collection and recovery of taxes shall apply in a case where a foreign company is said to be resident in India in any previous year on account of its POEM being in India and the such foreign company has not been resident in India before the said previous year.

Particulars	Provisions
Determination of opening WDV	If the foreign company is assessed to tax in the foreign jurisdiction Where depreciation is taken into account for the purpose of computation of its taxable income, the WDV of the depreciable asset as per the tax record in the foreign country on the 1st day of the previous year shall be adopted as the opening WDV for the said previous year. Where WDV is not available as per tax records, the WDV shall be calculated assuming that the asset was installed, utilised and the depreciation was actually allowed as per the provisions of the laws of that foreign jurisdiction. The WDV so arrived at as on the 1st day of the previous year shall be adopted to be the opening WDV for the said previous year. If the foreign company is not assessed to tax in the foreign jurisdiction WDV of the depreciable asset as appearing in the books of account as on the 1st day of the previous year maintained in accordance with the laws of that foreign jurisdiction shall be adopted as the opening WDV for the said previous year.
Brought forward loss and unabsorbed depreciation	If the foreign company is assessed to tax in the foreign jurisdiction Brought forward loss and unabsorbed depreciation as per the tax record shall be determined year wise on the 1st day of the said previous year. If the foreign company is not assessed to tax in the foreign jurisdiction

	Brought forward loss and unabsorbed depreciation as per the books of account prepared in accordance with the laws of that country shall be determined year wise on the 1st day of the said previous year. Other provisions Such brought forward loss and unabsorbed depreciation shall be deemed as loss and unabsorbed depreciation brought forward as on the 1st day of the said previous year and shall be allowed to be set off and carried forward in accordance with the provisions of the Act for the remaining period calculated from the year in which they occurred for the first time taking that year as the first year. However, the losses and unabsorbed depreciation of the foreign company shall be allowed to be set off only against such income of the foreign company which has become chargeable to tax in India on account of its being resident in India due to application of POEM. In cases the brought forward loss and unabsorbed depreciation originally adopted in India are revised or modified in the foreign jurisdiction due to any action of the tax or legal authority, the amount of the loss and unabsorbed depreciation shall be revised or modified for the purposes of set off and carry forward in India.
Accounting year of foreign company does not end on 31st March	The foreign company is required to prepare profit and loss account and balance sheet for the period starting from the date on which the accounting year immediately following said accounting year begins, upto 31st March of the year immediately preceding the period beginning with 1st April and ending on 31st March during which the foreign company has become resident. Examples: Example 1: If the accounting year of the foreign company is a calendar year and the company becomes resident in India during P.Y. 2018-19 for the first time due to its POEM in India, then, the company is required to prepare profit and loss account and balance sheet for the period 1st January, 2018 to 31st March, 2018. Example 2: If the accounting year of the foreign company is from 1st July to 30th June and the company becomes resident in India during P.Y. 2018-19 for the first time due to its POEM in India, then, the company is required to prepare profit and loss account and balance sheet for the period 1st July, 2017 to 31st March, 2018. The foreign company is also be required to prepare profit and loss account and balance sheet for succeeding periods of twelve months, beginning from 1st April and ending on 31st March, till the year the foreign company remains resident in India on account of its POEM. For the purpose of carry forward of loss and unabsorbed depreciation If the above period is less than 6 months, the period shall be included in that accounting year. Continuing in the example 1, since the period 1st January, 2018 to 31st March, 2018 is less than 6 months, it is to be included in the accounting year immediately preceding the accounting year in which the foreign company is held to be resident in India and the profit and loss and balance sheet of the 15 months from 1 January, 2017 to 31st March, 2018 is to be prepared.

	If the above period equal to or more than 6 months, that period shall be treated as a separate accounting year. Continuing in the example 2, since the period is more than 6 months, it is to be treated as a separate accounting year. The loss and unabsorbed depreciation as per tax record or books of account, as the case may be, of the foreign company shall, be allocated on proportionate basis.
Applicability of provisions of Chapter XVII-B (TDS provisions)	Where more than one provision of Chapter XVII-B of the Act applies to the foreign company as resident as well as foreign company, the provision applicable to the foreign company alone shall apply. Compliance to those provisions of Chapter XVII-B of the Act as are applicable to the foreign company prior to its becoming Indian resident shall be considered sufficient compliance to the provisions of said Chapter. The provisions of section 195(2) relating to application to Assessing Officer to determine the appropriate proportion of sum chargeable to tax shall apply in such manner so as to include payment to the foreign company.
Availability of deduction under section 90 or 91 (Foreign tax credit)	The foreign company shall be entitled to relief or deduction of taxes paid in accordance with the provisions of section 90 or section 91 of the Act. Where income on which foreign tax has been paid or deducted, is offered to tax in more than one year, credit of foreign tax shall be allowed across those years in the same proportion in which the income is offered to tax or assessed to tax in India in respect of the income to which it relates and shall be in accordance with the provisions of rule 128 of the Income-tax Rules, 1962.
Non applicability of the notification	The above exceptions, modifications and adaptations shall not apply in respect of such income of the foreign company which otherwise would have been chargeable to tax in India, even if the foreign company had not become Indian resident
Applicability of the notification where foreign company becomes resident in the subsequent previous year also	In a case where the foreign company is said to be resident in India during a previous year, immediately succeeding a previous year during which it is said to be resident in India; the exceptions, modifications and adaptations shall apply to the said previous year subject to the condition that the WDV, the brought forward loss and the unabsorbed depreciation to be adopted on the 1st day of the previous year shall be those which have been arrived at on the last day of the preceding previous year in accordance with the provisions of this notification.
No effect on other transactions	Any transaction of the foreign company with any other person or entity under the Act shall not be altered only on the ground that the foreign company has become Indian resident.
Applicability of other provisions relating to foreign company	The foreign company shall continue to be treated as a foreign company even if it is said to be resident in India and all the provisions of the Act shall apply accordingly. Consequently, the provisions specifically applicable to,— (i) a foreign company, shall continue to apply to it; (ii) non-resident persons, shall not apply to it; and (iii) the provisions specifically applicable to resident, shall apply to it.
Applicability of tax rate on	In case of conflict between the provision applicable to the foreign company as resident and the provision applicable to it as foreign company, the later shall generally prevail.

foreign company	Therefore, the rate of tax in case of foreign company i.e., 40% shall remain the same, i.e., rate of income-tax applicable to the foreign company even though residential status of the foreign company changes from non-resident to resident on the basis of POEM.
Applicability of notification	This notification shall be deemed to have come into force from the 1st day of April, 2017.
Meaning of foreign jurisdiction	The place of incorporation of the foreign company
Applicability of rule 115 of the Income-tax Rules, 1962.	The rate of exchange for conversion into rupees of value expressed in foreign currency, wherever applicable, shall be in accordance with provision of rule 115 of the Income-tax Rules, 1962.

15.1 | PRESS RELEASE

1. Press Release, dated 17-09-2018

Exemption to interest income on specified off-shore Rupee Denominated Bonds

Interest payable by an Indian company or a business trust to a non-resident, including a foreign company, in respect of rupee denominated bond issued outside India before 1.7.2020 is liable for concessional rate of tax of 5%. Consequently, section 194LC provides for the deduction of tax at a lower rate of 5% on the said interest payment.

Consequent to review of the state of economy on 14.9.2018 by the Prime Minister, the Finance Minister has announced a multi-pronged strategy to contain the Current Account Deficit (CAD) and augment the foreign exchange inflow. In this background, low cost foreign borrowings through off-shore rupee denominated bond have been further incentivised to increase the foreign exchange inflow.

Accordingly, it has been decided that **interest payable by an Indian company or a business trust to a non-resident, including a foreign company, in respect of rupee denominated bond issued outside India during the period from 17.9.2018 to 31.3.2019 shall be exempt from tax, and consequently, no tax shall be deducted on the payment of interest in respect of the said bond under section 194L.**

PART – III

SUPREME COURT

DECISIONS

INCOMES WHICH DO NOT FORM PART OF TOTAL INCOME**Case Study****CIT v. HCL Technologies Limited [2018] 404 ITR 719****Supreme Court**

HCL Technologies Limited (HCL) is engaged in the business of development and export of computer software and rendering technical services. For the relevant assessment year, the assessee claimed deduction under section 10AA as per certificates filed in the prescribed form. While computing deduction under section 10AA, HCL reduced software development charges incurred in foreign exchange attributable to the delivery of technical services outside India from total turnover. The assessing officer rejected the computation on the reasoning that the term “total turnover” is not defined under the Act and therefore, such reduction from total turnover as computed by the assessee company is not in accordance with law. Is the action of the assessing officer tenable in law?

Issues Involved:- The issue under consideration is whether software development charges incurred in foreign exchange attributable to the delivery of technical services outside India, deductible from export turnover, be excluded from total turnover also for computing deduction under section 10AA.

Provisions Applicable:- Section 10AA of the Act provides deduction to the unit in SEZ in respect of profits and gains derived from export which shall be worked out as per following formula:

$$\text{Profits of the business of the unit} \times \frac{\text{Export turnover of the unit}}{\text{Total Turnover of the unit}}$$

Analysis/observation:- The term “total turnover” has not been defined in section 10AA under which the deduction is sought.

Clause (i) of Explanation 1 to section 10AA defines “export turnover” to mean the consideration that has been received for export of articles/things/services received. Normally the consideration will include the freight/telecommunication charges/insurance which had been incurred to deliver the article/things or expenses incurred in rendering of services outside India. However, clause (i) of Explanation 1 specifically seeks to exclude these three categories of expenditure for delivering the export of articles/things or expenses incurred in foreign exchange in rendering of services outside India.

When a particular word such as “total turnover” is not defined by the legislature, ordinary meaning is to be attributed in conformity with the context in which it is used. Section 10AA deduction depends on arriving at the profit from export business, thus, expenses excluded from “export turnover” must also be excluded from “total turnover”, since one of the components of “total turnover” is export turnover. Expenses incurred in foreign exchange for providing the technical services outside are thus, to be excluded from total turnover also.

If deductions in respect of freight, telecommunication charges and insurance attributable to delivery of articles, things etc. or expenditure incurred in foreign exchange in rendering of services outside India are allowed only against export turnover but not from the total turnover for computing deduction under section 10AA, then, it would give rise to inadvertent, unlawful, meaningless and illogical results causing grave injustice, which could have never have been the intent of the Legislature. Hence, such expenditure incurred in foreign exchange for providing technical services outside India are deductible from total turnover also.

It was so held by the Supreme Court in **CIT v. HCL Technologies Limited [2018] 404 ITR 719**.

(Though the above decision of the Supreme Court is in relation to erstwhile section 10A, the same is also relevant in the context of section 10AA.)

Conclusion:- Applying the rationale of the above court ruling, the action of the assessing officer in rejecting computation of deduction under section 10AA is not tenable in law.

Readers Note:

INCOME FROM HOUSE PROPERTY**Case Study****Raj Dadarkar and Associates v. ACIT [2017] 394 ITR 592****Supreme Court**

Raj Dadarkar and Associates (assessee) acquired the right to conduct a market on certain land from Municipal Corporation, Greater Bombay under an auction on May 28, 1993. The premises allotted to it was a bare structure and it was for the assessee. The appellant spent substantial sums to construct 95 shops and 30 stalls. From the years 1999 to 2004, the assessee treated income from sub-letting of such shops and stalls as business income. The return of the assessee for assessment year 2000-2001 was reopened by Assessing Officer by issuing notice under section 148 treating the same as income under the head 'Income from house property'. The assessee produced partnership deed wherein the object clause reads as under:

"The Partnership shall take the premises on rent to sub-let or do any other business as may be mutually agreed by the parties from time to time." The assessing officer, rejecting the contention of assessee, treated such income under the head "Income from house property".

Whether the action of assessing officer is justified?

Issues Involved:- Whether the income earned by the appellant is to be taxed under the head 'Income from house property' or 'Profits and gains from the business or profession'?

Provisions Applicable:- Section 22 and Section 28

Analysis/observation:- Wherever there is an income from leasing out of premises, it is to be treated as income from house property. However, it can be treated as business income if letting out of the premises itself is the business of the assessee. The question has to be decided based on the facts of each case as was held in *Sultan Brothers Pvt Ltd. v. CIT* [1964] 51 ITR 353 (SC).

In the given facts, it was an undisputed fact that the assessee **would be considered to be a deemed owner under section 27(iiiB)** read with section 269UA(f) as it had a leasehold right for more than 12 years.

The only evidence adduced for proving that letting out and earning rents is the main business activity of the appellant was the object clause of the partnership deed. The clause provided that "The Partnership shall take the premises on rent to sub-let or do any other business as may be mutually agreed by the parties from time to time."

This clause is not conclusive and sufficient to show that its entire or substantial income was from letting out of the property. And therefore, in this case, the income is to be assessed as "Income from house property" and not as business income, on account of lack of sufficient material to prove that the substantial income of the assessee was from letting out of the property.

It was so held by **Supreme Court in case of Raj Dadarkar and Associates v. Assistant Commissioner of Income Tax [2017] 394 ITR 592 (SC)**.

Conclusion:- Therefore, the contention of the assessing officer is justified in this case taxing such income under the head "Income from house property".

Readers Note:

PROFITS AND GAINS FROM BUSINESS OR PROFESSION

Case Study

Berger Paints India Ltd. v. CIT [2017] 393 ITR 113

Supreme Court

Berger Paints India Ltd (assessee) is a company engaged in the manufacture of paints. For the relevant assessment years, the assessee claimed deduction under section 35D of a sum representing share premium as being a part of the capital employed. However, the assessing officer stick to the definition of capital employed given under section 35D of the Act and therefore, not included share premium under “capital employed”. Whether the action of assessing officer is justified?

Issue involved: The issue under consideration is whether “premium” on subscribed share capital can be treated “capital employed in the business of the company” under section 35D to be eligible for increased deduction.

Provisions Applicable:- Section 35D :

Meaning of Capital Employed: It is the aggregate of the issued share capital, debentures and long-term borrowings, as on the last day of the previous year in which the business of the company commences.

Analysis/observation:- The Supreme Court observed that the share premium collected by the assessee on its subscribed issued share capital could not be part of “capital employed in the business of the company” for the purpose of section 35D(3)(b). If it were the intention of the legislature to treat share premium as being “capital employed in the business of the company”, it would have been explicitly mentioned.

Moreover, column III of the form of the annual return in Part II of Schedule V to the Companies Act, 1956 under Section 159 dealing with capital structure of the company provides the break-up of “issued share capital” which does not include share premium at the time of subscription.

Hence, in the absence of the reference in section 35D, share premium is not a part of the capital employed. Also, section 78 of the Companies Act, 1956 requires a company to transfer the premium amount to be kept in a separate account called “securities premium account”.

Conclusion:- The contention of the assessing officer is correct.

Readers Note:

Case Study

Palam Gas Service v. CIT [2017] 394 ITR 300

Supreme Court

There have been conflicting interpretations by judicial authorities regarding disallowance under section 40(a)(ia). In that one of the view in favour of assessee was that disallowance under section 40(a)(ia) would be invoked only in respect of the amount which remained payable at the end of relevant financial year and not in respect of the amount which had actually been paid during the previous year without deduction of tax at source. This conflict has been done away by Supreme Court. You are required to mention that in whose favour conflict has been resolved and what are the reasons awarded by Supreme Court for bringing down the conflict.

Issue involved: Whether the provisions of Section 40(a)(ia) would be attracted when the amount is not 'payable' to a sub-contractor but has been actually paid? Would the obligation to deduct tax depend on the method of accounting followed by an assessee?

Provisions Applicable:- Section 40(a)(ia)

Analysis/observation:- **Supreme Court in case of Palam Gas Service vs. CIT** held that Section 40(a)(ia) covers not only those cases where the amount is payable but also when it is paid. In this behalf, one has to keep in mind the purpose with which Section 40 was enacted and that has already been noted above. We have also to keep in mind the provisions of Sections 194C and 200. Once it is found that the aforesaid sections mandate a person to deduct tax at source not only on the amounts payable but also when the sums are actually paid to the contractor, any person who does not adhere to this statutory obligation has to suffer the consequences which are stipulated in the Act itself.

Certain consequences of failure to deduct tax at source from the payments made, where tax was to be deducted at source or failure to pay the same to the credit of the Central Government, are stipulated in Section 201 of the Act. This Section provides that in that contingency, such a person would be deemed to be an assessee in default in respect of such tax. While stipulating this consequence, Section 201 categorically states that the aforesaid Sections would be without prejudice to any other consequences which that defaulter may incur. Other consequences are provided under Section 40(a)(ia) of the Act, namely, payments made by such a person to a contractor shall not be treated as deductible expenditure. When read in this context, it is clear that Section 40(a)(ia) deals with the nature of default and the consequences thereof. Default is relatable to Chapter XVIIIB (in the instant case Sections 194C and 200, which provisions are in the aforesaid Chapter). When the entire scheme of obligation to deduct the tax at source and paying it over to the Central Government is read holistically, it cannot be held that the word 'payable' occurring in Section 40(a)(ia) refers to only those cases where the amount is yet to be paid and does not cover the cases where the amount is actually paid.

If the provision is interpreted in the manner suggested by the appellant herein, then even when it is found that a person, like the appellant, has violated the provisions of Chapter XVIIIB (or specifically Sections 194C and 200 in the instant case), he would still go scot free, without suffering the consequences of such monetary default in spite of specific provisions laying down these consequences.

Conclusion:- The provisions of section 40(a)(ia) would be attracted for failure to deduct tax in both cases i.e., when the amount is payable or when the amount is paid, as the case may be, depending on the system of accounting followed by the assessee.

Readers Note:

Case Study

Honda Siel Cars India Ltd. v. CIT [2017] 395 ITR 713

SUPREME COURT

Honda Siel Cars India Ltd. (assessee), is a joint venture company between Honda Motors, a Japanese company and Siel Ltd., an Indian company. The assessee and Honda Motors entered into a technical collaboration agreement (TCA) on May 21, 1996 under which a technical fee of 30.5 million USD was payable by the assessee in five equal instalments on a yearly basis. Under the TCA, Honda Motors had to provide manufacturing facilities, know-how, technical information, information regarding intellectual property rights to the assessee which the assessee was entitled to exploit only as a licensee, without any proprietary rights.

Whether the technical fee of 30.5 million USD payable by the assessee is in the nature of revenue expenditure or capital expenditure?

Issues Involved:- Whether the technical fee of 30.5 million USD payable by the assessee is in the nature of revenue expenditure or capital expenditure?

Provisions Applicable:- Section 37(1)

Analysis/observation:- If a limited right to use technical know-how is obtained for a limited period for improvising existing business, the expenditure is revenue in nature.

However, if technical know-how is obtained for setting up a new business, the position may be different. (That means it would be of capital nature)

There is no single principle or test for determining the nature of expenditure; it is a question to be answered based on the circumstances in each case.

In the given facts, the very purpose of the TCA was to set up the Joint Venture. The collaboration included not only transfer of technical information, but, complete assistance, actual, factual and on the spot, for establishment of plant, machinery, etc. so as to set up a manufacturing unit. Upon termination of TCA, the joint venture itself would come to an end.

Though the TCA is framed in a manner to look like a licence for a limited period having no enduring nature but a close scrutiny into the said agreement shows otherwise.

In this case, technical fee is capital in nature since upon termination of TCA, the joint venture itself would come to an end.

It was so held by **Supreme Court in case of Honda Sael Cars India Ltd. v. CIT [2017] 395 ITR 713 (SC).**

Conclusion:- The technical fee of 30.5 million USD payable by the assessee is in the nature of capital expenditure.

Readers Note:

Case Study

CIT v. Mahindra and Mahindra Ltd. [2018] 404 ITR 1

SUPREME COURT

Mahindra and Mahindra Ltd. decided to expand its jeep product line and entered into an agreement with Kaiser Jeep International Corporation (KJIC), an American company, which agreed to sell it dies, welding equipment and die models. The purchase consideration was agreed at \$ 650,000 including cost, insurance and freight and KJIC agreed to advance a loan to the assessee at 6% interest repayable after 10 years in instalments. The Reserve Bank of India and the concerned Ministry approved the loan agreement.

Later on, American Motor Corporation (AMC) took over KJIC and agreed to waive the principal amount of loan advanced by K to the assessee-company and to cancel the promissory notes as and when they matured. This was communicated to the assessee-company which filed its return showing Rs.57,74,064 as cessation of its liability towards AMC. The Income-tax Officer concluded that the waiver of the loan amount represented income and held that the sum of Rs.57,74,064 was taxable under section 28(iv) as a perquisite. The alternate argument of the revenue authorities was that the sum would be taxable under section 41(1) as a waiver of a trading liability. Discuss the validity of the contention of the revenue.

Issues Involved:- Where the waiver in respect of loan taken for purchase of plant and machinery and tooling equipment, would be subject to tax in the hands of assessee by virtue of the provisions contained in either section 28(iv) or section 41(1)?

Provisions Applicable:- Section 28(iv) provides that any benefit or perquisite arising from exercise of business or profession shall be taxable under the head "PGBP". Section 41(1) provides taxability of refund or cessation of liability in respect of loss, expenditure or trading liability which has been claimed as deduction in past.

Analysis/observation:- On a plain reading of Section 28 (iv) of the IT Act, prima facie, it appears that for the applicability of the said provision, the income which can be taxed shall arise from the business or profession. Also, in order to invoke the provision of Section 28 (iv) of the IT Act, the benefit which is received has to be in some other form rather than in the shape of money. In the present case, it is a matter of record that the amount of Rs. 57,74,064/- is having received as cash receipt due to the waiver of loan. Therefore, the very first condition of Section 28 (iv) of the IT Act which says any benefit or perquisite arising from the business shall be in the form of benefit or perquisite other than in the shape of money, is not satisfied in the present case.

For being covered under section 41(1), the assessee-company should have claimed an allowance or deduction in any assessment for any year in respect of a trading liability incurred by the assessee. Subsequently, during any previous year, if the creditor waives such liability, the assessee-company would be liable to pay tax under section 41. In this case, the loan was taken for procurement of capital assets, namely, plant, machinery and tooling equipment. The purchase amount had not been debited to the trading account or to the profit and loss account in any of the assessment years. There is difference between 'trading liability' and 'other liability'. Section 41(1) deals with the remission of trading liability. Whereas in the instant case, waiver of loan amounts to cessation of liability other than trading liability. Therefore, there is no force in the argument of Revenue that the case of the assessee would fall under section 41(1) of the Act.

It was so held by Supreme Court in **CIT v. Mahindra and Mahindra Ltd. [2018] 404 ITR 1.**

Conclusion:- Applying the rationale of the above court ruling, the contention of revenue that waiver of loan would be subject to tax in the hands of assessee, is not valid.

Readers Note:

CAPITAL GAINS**Case Study****Balakrishnan v. Union of India & Others (2017) 391 ITR 178****Supreme Court**

The assessee owned vast area of agricultural land. The State Government acquired the property for development of a techno park. The assessee was awarded compensation of Rs.14.37 lakhs. Aggrieved by the amount, the assessee initiated negotiations with the Collector, further to which compensation was increased to Rs.38.42 lakhs. The assessee claimed exemption from capital gains under section 10(37)(iii) stating that the transfer of agricultural land was on account of compulsory acquisition. The Revenue authorities contended that the exemption should be denied as it was not a compulsory acquisition but a voluntary sale. Whether contention of revenue is correct?

Issue involved: Whether receipt of higher compensation on account of negotiations transforms the character of compulsory acquisition into a voluntary sale, so as to deny exemption under section 10(37)(iii)?

Provisions Applicable:- Section 10(37)(iii) of the Act

Analysis/observation:- The Supreme Court observed that the acquisition process was initiated under the Land Acquisition Act, 1894. The assessee entered into negotiations only for securing the market value of the land without having to go to the Court.

Merely because the compensation amount is agreed upon, the character of acquisition will not change from compulsory acquisition to a voluntary sale.

The Court also drew attention to a recently enacted legislation titled, Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act, 2013, which empowers the Collector to pass an award with the consent of the parties. Despite the provision for consent, the acquisition would continue to be compulsory.

The Supreme Court held that when proceedings were initiated under the Land Acquisition Act, 1894, even if the compensation is negotiated and fixed, it would continue to remain as compulsory acquisition. The claim of exemption from capital gains u/s 10(37)(iii) is, therefore, tenable in law.

Conclusion:- Considering the above, the action of revenue is not justified in rejecting the claim of exemption from capital gains u/s 10(37)(iii).

Readers Note:

INCOME FROM OTHER SOURCES

Case Study

Gopal & Sons (HUF) v. CIT (2017) 391 ITR 1

Supreme Court

Gopal & Sons (HUF) holds 37.12% shares of M/s. G. S. Fertilizers (P.) Ltd., a closely held company. During the relevant previous year, it received loans and advances from the company. Its return was scrutinized by the Assessing Officer who treated the loans and advances as deemed dividend under section 2(22)(e). As per the company's annual return, the HUF is the shareholder. However, the share certificates were issued in the name of the HUF's Karta, Shri Gopal Kumar Sanei. Thus, there was dispute as to who was the shareholder - the Karta, Mr. Shri Gopal Kumar Sanei or the HUF, as share certificates were issued in the name of the former but the annual return mentioned the latter.

Gopal & Sons (HUF) contended that HUF cannot be a registered or beneficial shareholder of a company, the amount of loan cannot be taxed as deemed dividend.

Examine whether the loan given by a closely held company to a HUF is chargeable to tax as deemed dividend under section 2(22)(e)?

Issue involved: The issue under consideration in this case is whether loan to HUF by a closely held company is chargeable to tax as deemed dividend, where the share certificates were in the name of the Karta of the HUF but the annual return mentioned the HUF as a shareholder.

Provisions Applicable:- Section 2(22)(e) which provides as under:

When a loan is given by a closely held company, it is chargeable to tax as deemed dividend if the loan is given to:

- (i) a shareholder (having 10% or more voting power in the company) or
- (ii) a concern in which such shareholder is a member or partner and in which he has substantial interest (entitled to 20% of the income of such concern).

Analysis/observation:- This issue came up before the **Supreme Court in Gopal & Sons (HUF) v. CIT (2017) 391 ITR 1**, wherein it was observed that, in either scenario, section 2(22)(e) would be attracted. If the HUF was the shareholder, as it held more than 10% voting power, the provisions of section 2(22)(e) would be covered under (i) above. If the Karta was the shareholder, the HUF would be the concern in which the Karta is a member, and hence, the case would be covered under (ii) above.

As per Explanation 3 to section 2(22)(e), "concern" has been defined to mean a HUF, or a firm or an AOP or a BOI or a company. The Supreme Court, accordingly, held that the loan to HUF is to be assessed as deemed dividend under section 2(22)(e).

Conclusion:- The loan given by the M/s. G.S. Fertilizers (P) Ltd. to Gopal & Sons (HUF) is treated as deemed dividend under section 2(22)(e) of the Act.

Readers Note:

Case Study

CIT v. Sree Rama Multi Tech Ltd. [2018] 403 ITR 426

Supreme Court

The Sree Rama Muti Tech Ltd. is engaged in the manufacture of multi-layer tubes and other speciality packaging and plastic products. It came out with an initial public issue of shares during the relevant assessment years and deposited the share application money received in banks. The interest of Rs. 1,71,30,202 earned on the deposits was set off against the public issue expenses. While the contention of Revenue was that such interest shall be taxed under the head "Income from Other Sources". Whether the contention of the Revenue is valid?

Issue involved: Is interest income from share application money deposited in bank eligible for set-off against public issue expenses or should such interest be subject to tax under the head 'Income from Other Sources'?

Provisions Applicable:- Section 56 of the Act.

Analysis/observation:- The assessee-company was statutorily required to keep share application money in a separate account till the allotment of shares was completed. Part of the share application money would normally have to be returned to unsuccessful applicants, and therefore, the entire share application money would not

ultimately be appropriated by the company. The interest earned was inextricably linked with the requirement of raising share capital.

Any surplus money deposited in the bank for the purpose of earning interest is liable to be taxed as "Income from Other Sources". Here, the share application money was deposited with the bank not to make additional income but to comply with the statute. The interest accrued on such deposit is merely incidental.

Moreover, the issue of shares relates to capital structure of the company and hence, expenses incurred in connection with the issue of shares are to be capitalized. Accordingly, the accrued interest is not liable to be taxed as "Income from Other Sources"; the same is eligible to be set-off against public issue expenses.

It was so held by Supreme Court in **CIT v. Sree Rama Multi Tech Ltd. [2018] 403 ITR 426 (SC)**. Supreme Court, in this case, followed the ratio of Bokaro Steel Ltd. and Karnal Co-operative Sugar Mills Ltd. (2000) 243 ITR 2 wherein company had deposited certain amount with the bank to open letter of credit for purchase of machinery for setting up plant. On the money so deposited, it earned interest. In that background, Supreme Court observed that this is not a case where any surplus shares capital money which was lying idle had been deposited in the bank for the purpose of earning interest. The deposit of money is directly linked with the purchase of plant and machinery.

Conclusion:- Applying the rationale of the above court ruling, the contention of revenue that the interest shall be taxed under the head "Income from Other Sources" is not valid.

Readers Note:

AGGREGATION OF INCOME, SET OFF OR CARRY FORWARD OF LOSSES DEDUCTIONS FROM GROSS TOTAL INCOME

Case Study

CIT v. Container Corporation of India Limited [2018] 404 ITR 397

Supreme Court

M/s. Container Corporation of India Ltd. (CONCOR) is a Government company engaged in the business of handling and transportation of containerized cargo. Its operating activities are mainly carried out at its Inland Container Depots, Container Freight Stations and Port Side Container Terminals. CONCOR filed its income-tax returns for the relevant assessment years and claimed deduction under various heads including deduction under section 80-IA for profits derived from inland container depots (ICDs). The claim for deduction on the profits earned from inland container depots was, however, rejected by the Assessing Officer on the ground that it does not fall within the meaning of term "Infrastructure facility". Is the action of assessing officer valid in law?

Issue involved: Whether Inland Container Depots (ICDs) be treated as infrastructure facility, for profits derived therefrom to be eligible for deduction under section 80-IA?

Provisions Applicable:- Section 80-IA – Meaning of term "Infrastructure Facility"

Analysis/observation:- Inland Container Depots function for the benefit of exporters and importers located in industrial centres which are situated at distance from sea ports. The purpose of establishing them was to promote the export and import in the country as these depots acts as a facilitator and reduce inconvenience to the exporter or importer.

Section 80-IA provides for a deduction of profits derived from operation of an infrastructure facility. The Finance Act, 2001 substituted section 80-IA(4), consequent to which the definition of "infrastructure facility" in Explanation to section 80-IA(4)(i) included an inland port.

The term "Inland Port" has been defined nowhere. Considering the nature of work such as custom clearance carried out at inland container depots, it can be considered as an inland port within the meaning of section 80-IA(4).

It was so held by Supreme Court in case of **CIT v. Container Corporation of India Limited [2018] 404 ITR 397 (SC)**

Conclusion:- Applying the rationale of above court ruling, CONCOR can claim for deduction under Section 80-IA in respect of profits derived from Inland Container Depots and therefore the action of the assessing officer rejecting claim of deduction under section 80-IA is bad in law.

Readers Note:

ASSESSMENT OF VARIOUS ENTITIES

Case Study

Union of India v. Tata Tea and Others [2017] 398 ITR 260

Supreme Court

Tata Tea Ltd. is a tea company engaged in cultivating and processing tea in its factory for marketing. The company distributed dividend to its shareholders. The Assessing Officer was of the view that the entire dividend is subject to dividend distribution tax. The company, however, contended that the tax on dividend declared by it in this case is nothing but a tax on agricultural income; and the legislative competence for taxing agricultural income lies with the State Government and not the Central Government. On appeal, the Appellate Authority held that since the company is carrying on cultivation of tea, which is an agricultural process as also the processing of tea in the factory, which is an industrial process, 40% of dividend distributed by the company is to be taxed under Section 115-O. Discuss the correctness or otherwise of the contention of the Appellate Authority.

Issue involved: The issue under consideration is whether dividend distribution tax under section 115-O can be levied on dividend income of a tea company, and if so, whether in whole or in part, to be restricted to 40%, being the proportion of business income of a tea company.

Provisions Applicable:- Entry 82 of List I and Section 115-O.

Analysis/observation:- This issue came up before the **Supreme Court in Union of India v. Tata Tea and Others [2017] 398 ITR 260 (SC)**.

The Supreme Court observed that as per Entry 82 of List I, the Union Parliament has the competence to tax "income other than agricultural income". Section 115-O pertains to additional tax at the stage of distribution of dividend by a domestic company which is covered by Entry 82 in List I. When dividend is declared to be distributed and paid to a company's shareholders, it is not impressed with character of the source of its income. The Court relied on *Mrs. Bacha F Guzdar v. CIT* AIR 1955 SC 74 which looked into the nature of the dividend income in the hands of the shareholders. Dividend is derived from the investment made in the company's shares and the foundation rests on the contractual relations between the company and the shareholder.

Dividend is not 'revenue derived from land' and therefore, cannot be termed as agricultural income in the hands of a shareholder. Hence, despite the company being involved in agricultural activities, in the shareholder's hands, the income is only dividend and not agricultural income.

The Calcutta High Court had upheld the vires of section 115-O but put a qualification that additional tax levied under section 115-O shall be only to the extent of 40% which is the taxable income of the tea company. The Supreme Court overturned this cap placed by the Calcutta High Court. Section 115-O is within the competence of the Parliament and hence, no limits can be placed on the same.

Conclusion:- Accordingly, the contention of the Appellate Authority that only 40% of dividend distributed by the company is to be taxed under section 115-O is not correct. The entire dividend distributed would be subject to dividend distribution tax under section 115-O.

Readers Note:

Case Study

ITO v. Venkatesh Premises Co-operative Society Ltd. [2018] 402 ITR 670

Supreme Court

Venkatesh Premises Co-operative Society Ltd. has collected (i) non-occupancy charges from the member who does not himself occupy the premises but let it out to a third person (ii) transfer fee paid by the transferee member (iii) common amenity fund charges from a member disposing property and claimed that such charges / fees shall not be taxable in its hand on the principles of mutuality. However, the income tax officer taxed the same. Whether the action of assessing officer is correct?

Issue involved: Whether certain receipts by co-operative societies from its members (non-occupancy charges, transfer charges, common amenity fund charges) are exempt based on the doctrine of mutuality?

Provisions Applicable:- Section 2(24) of the Act.

Analysis/observation:- Supreme Court in case of *Income-tax Officer v. Venkatesh Premises Co-operative Society Ltd.* [2018] 402 ITR 670 (SC) made following observations:

The doctrine of mutuality is based on the common law principle that a person cannot make a profit from himself. The income of a co-operative society from business is taxable under section 2(24)(vii) and will stand excluded based on the principle of mutuality. The essence of the principle of mutuality lies in the commonality of the contributors and the participants who are also the beneficiaries. The contributors to the common fund must be entitled to participate in the surplus and the participants in the surplus are contributors to the common fund. Any surplus in the common fund shall, therefore, not constitute income but will only be an increase in the common fund meant to meet sudden eventualities.

If for convenience, part of the transfer charges were paid by the transferee, they would not partake of the nature of profit. The amount is appropriated only after the transferee was inducted as a member. In the event of non-admission, the amount was returned. The moment the transferee was inducted as a member the principles of mutuality would apply.

- Non-occupancy charges were levied by the society and were payable by a member who did not himself occupy the premises but let them out to a third person. The charges were utilised only for common benefit of facilities and amenities to the members.
- Contribution to the common amenity fund taken from a member disposing of property was utilized for meeting heavy repairs to ensure hazard-free maintenance of the properties of the society which ultimately benefitted the members. Membership forming a class, the identity of the individual member not being relevant, induction into membership automatically attracted the doctrine of mutuality.

Conclusion:- The doctrine of mutuality, is based on the common law principle that a person cannot make a profit from himself. Accordingly, the transfer charges, non-occupancy charges common amenity fund charges are exempt owing to application of the doctrine of mutuality. Therefore, the action of the assessing officer, taxing such receipts in the hands of society is not correct.

Readers Note:

***CHARITABLE OR RELIGIOUS TRUSTS AND INSTITUTIONS, POLITICAL
PARTIES AND ELECTORAL TRUSTS***

DEDUCTION, COLLECTION AND RECOVERY OF TAX**Case Study****CIT (TDS) and Anr v. Canara Bank [2018] 406 ITR 161****Supreme Court**

Canara Bank made a payment of Rs. 20.10 crores as interest on deposits to New Okhla Industrial Development Authority (NOIDA) for the relevant financial year without deducting tax at source. The Commissioner of Income-tax (TDS) issued notice to the Canara Bank, asking for information pertaining to interest paid and for showing cause for not deducting tax at source under section 194A. In response to the notice, reply was filed by the Canara Bank that there is no need to deduct tax at source in view of the notification dated October 20, 1970 under section 194A(3)(iii)(f) exempting payments made to “any corporation established by a Central, State or Provincial Act” from the requirement of tax deduction at source. The contention of the revenue was that NOIDA was constituted by a notification dated April 17, 1976 issued under section 3 of the Uttar Pradesh Industrial Development Act, 1976 and not established by the State Act and therefore Canara Bank has committed default in deducting tax at source while making payment of interest to NOIDA.

Whether the contention of revenue is tenable in the eyes of law?

Issue involved:- Can payment of interest by Canara Bank to NOIDA be exempted from the requirement of tax deduction at source under section 194A on the ground that the same is a corporation established by or under the Uttar Pradesh Industrial Area Development Act, 1976?

Provisions Applicable:- Section 194A(3)(iii)(f) of the Act

Analysis/observation:- The Supreme Court explained a ‘corporation’ as an artificial being created by law having a legal entity entirely separate and distinct from the individuals who compose it with the capacity of continuous existence and succession, notwithstanding changes in its membership. There was no dispute about NOIDA being a corporation and a statutory corporation. The only question was whether it was established by a State legislation and thus covered under the notification dated October 20, 1970.

Relying on the ratio of *Dalco Engineering Pvt. Ltd. v. Shree Satish Prabhakar Padhye* [2011] 164 Comp Cas 275 (SC), the Court held that the phrase “established by or under” is used to denote a statutory corporation established or brought into existence by or under a statute. The establishment of Corporation is by a notification issued by State Government. In the present case, notification has been issued by the State Government in exercise of power of section 3 and the Authority has been constituted.

Conclusion:- The contention of revenue is not tenable in the eyes of law. The Canara bank has rightly not deducted tax at source because NOIDA is clearly covered under the Notification dated October 22, 1970.

Readers Note:

Case Study**Prasar Bharati v. CIT [2018] 403 ITR 161****Supreme Court**

The assessee, Prasar Bharati Doordarshan Kendra (PBDK), functions under the Ministry of Information and Broadcasting, Government of India and runs the television channel called Doordarshan. For the purpose of telecasting advertisements of consumer companies on its channel, the PBDK entered into agreements with advertising agencies, on the basis of the application made by such agencies to the assessee for gaining “accredited status”. The agencies were to give minimum annual business of Rs.6 lakhs to the PBDK in a financial year and furnish bank guarantee for a sum of Rs.3 lakhs. The agreement provided that the accredited agencies would retain 15% by way of commission out of the amount collected from customers and paid to the PBDK. The agencies were to retain the commission earned and not to part with the same either directly or indirectly to any other person.

In the assessment year 2002-03 and 2003-04, the agencies retained Rs.2.57 crores and Rs. 2.30 crores towards commission as per the terms of the agreement. The Assessing Officer was of the view that such retention by the agencies were in the nature of “commission” under section 194H, and the PBDK was in default under section 201(1) as it had failed to deduct tax at source on such commission retained.

The PBDK, however, contended that its relationship with accredited agencies were on “principal-to-principal” basis since the accredited agencies purchased airtime from the PBDK and then sold it in the market for

advertisement to their customer after retaining 15% of the said sum. Therefore, the PBDK contended the sum retained is not 'commission' to attract the provisions of section 194H. Decide the validity of the contention of assessee.

Issue involved:- Whether the amount retained by the accredited agencies is in the nature of commission to attract the provisions of section 194H?

Provisions Applicable:- Section 194H – Meaning of term "Commission"

Analysis/observation:- The definition of "commission or brokerage" under section 194H is inclusive and covers any payment received or receivable directly or indirectly by a person acting on behalf of another person for the services rendered.

The agreement itself uses the expression "commission" in all relevant clauses. The payment clause is free of ambiguity and the terms of the agreement indicate that both parties intended that the amount to be paid/retained is in the nature of commission. It is for this reason that the parties used the expression "commission" in the agreement. The relationship in question was a pure agency arrangement because the agency acted on behalf of the assessee and the actions of the agency were binding on the assessee.

Moreover, the agreement itself contained a clause for deduction of tax at source on trade discount. And therefore, the amount retained by the accredited advertising agencies is commission and consequently, the provisions of tax deduction at source under Section 194H are attracted.

It was so held by Supreme Court in case of Director, **Prasar Bharati v. CIT [2018] 403 ITR 161 (SC)**

Conclusion:- Applying the rationale of above court ruling, the contention of PBDK that the sum retained is not a 'commission' so to attract the provisions of section 194H, is not valid.

Readers Note:

INCOME TAX AUTHORITIES**Case Study****CIT and Anr v. SV Gopala and Others [2017] 396 ITR 694****Supreme Court**

The CBDT had issued a Circular invoking the powers under Section 119 of the Income-tax Act, 1961. The Circular amended the provisions contained in Rule 68B of the Second Schedule to the Income-tax Act, 1961 relating to time limit for sale of attached immovable property. Whether CBDT has power to amend rules through a Circular?

Issue involved:- whether the CBDT has the power to amend legislative provisions through a Circular?

Provisions Applicable:- Section 119 of the Act.

Analysis/observation:- The Supreme Court observed that the CBDT does not have the power to amend legislative provisions in exercise of its powers under section 119 of the Income-tax Act, 1961 by issuing a Circular.

Conclusion:- The circular issued by the CBDT is ultra vires and liable to be quashed in as much as CBDT does not have power to amend the rules through a Circular.

Readers Note:

ASSESSMENT PROCEDURE**Case Study****ACIT v. ICICI Securities Primary Dealership Ltd. (2012) 348 ITR 299****Supreme Court**

ICICI Securities Primary Dealership Ltd. was subject to scrutiny assessment under section 143(3) of the Act for the relevant assessment year. The scrutiny assessment got completed 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. Whether action of assessing officer is justified in re-opening assessment under section 147?

Issue involved:- 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)?

Provisions Applicable:- Section 147 of the Act.

Analysis/observation:- 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.

Conclusion:- The action of assessing officer in re-opening the assessment under section 147 is bad in law.

Readers Note:

APPEALS AND REVISION

Case Study

CIT v. Meghalaya Steels Ltd. (2015) 377 ITR 112

Supreme Court

Does the High Court have an inherent power under the Income-tax Act, 1961 to review an earlier order passed on merits?

Issue involved:- Does the High Court have an inherent power under the Income-tax Act, 1961 to review an earlier order passed on merits?

Provisions Applicable:- Article 226 of the Constitution

Analysis/observation:-

- The Supreme Court in case of **CIT v. Meghalaya Steels Ltd. (2015) 377 ITR 112** 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, while dealing with power of review of writ petitions filed under article 226, the Supreme Court, in another case, 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.

Conclusion:-

Readers Note:

Case Study

CIT v. Amitabh Bachchan (2016) 384 ITR 200

Supreme Court

Mr. Amitabh Bachchan 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, it was 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 claimed 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. Whether action of commissioner under section 263 is justified?

Issue involved:- 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?

Provisions Applicable:- Section 263 of the Act.

Analysis/observation:- It was 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.

Conclusion:- The commissioner is empowered to revise the order passed by the assessing officer under section 263 of the Act on the ground that the order is passed without making inquiries or verification which should have been made.

Readers Note:

Case Study**CIT v. Subrata Roy (2016) 385 ITR 570****Supreme Court**

In case of Mr. Subrata Roy (assessee), the High Court of Allahabad has passed its order dated 27.08.2013 considering the submission of the counsel of the assessee and 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.

Thereafter, on 21.12.2014, 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 recalled its order 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.

Whether High Court is justified to recall its order even though the original order was not an ex-parte order and it was passed after considering the submission of counsel of the assessee (though not that of the senior counsel for whose presence a short adjournment was prayed)?

Issue involved:- Whether High Court has 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?

Provisions Applicable:- Section 260A(7) of the Act

Analysis/observation:- 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

- (i) 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; or
- (ii) where the notice is not served; or
- (iii) 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 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 Court did not have the jurisdiction to recall the order passed by it previously.

Conclusion:- 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 High Court of Allahabad is not justified to recall its order in the present case.

Readers Note:

Case Study**Spinacom India (P.) Ltd. v. CIT [2018] 258 Taxman 128****Supreme Court**

There has been a delay of 439 days in filing the appeal under section 260A (appeal to High Court) for which reason the Spinacom India (P.) Ltd. (SIPL) requested for a condonation of delay under section 14 of Limitation Act, 1963. The SIPL submitted that the delay was on account of pursuing an alternate remedy of filing a miscellaneous application before the Income-tax Appellate Tribunal (ITAT) under section 254(2). Whether the submission of SIPL for condonation of delay while filing an appeal to High Court constitute "sufficient cause"?

Issue involved:- Whether delay in filing appeal under section 260A can be condoned where the stated reason for delay is the pursuance of an alternate remedy by way of filing an application before the ITAT under section 254(2) for rectification of mistake apparent on record?

Provisions Applicable:- Section 260A of the Act which provides that the High Court may admit an appeal after the expiry of the period of 120 days, if it is satisfied that there was sufficient cause for not filing the appeal within 120 days.

Analysis/observation:- The application before the ITAT under section 254(2) was an alternate remedy to filing of the application under section 260A. The former is an application for rectifying a 'mistake apparent from the record' which is much narrower in scope than the latter. Under section 260A, an order of the ITAT can be challenged on substantial questions of law.

Therefore, the SIPL had the option of filing an appeal under section 260A while also mentioning in the Memorandum of Appeal that its application under section 254(2) was pending before the ITAT. The time period for filing an appeal under section 260A does not get suspended on account of the pendency of an application before the ITAT under section 254(2) of the Act.

Thus, no satisfactory reason has been provided by the SIPL for the extraordinary delay of 439 days in filing the appeal and therefore High Court is justified in refusing to condone the delay.

It was so held by Supreme Court in case of **Spinacom India (P.) Ltd. v. CIT [2018] 258 Taxman 128 (SC)** while dismissing the SLP of SIPL.

Conclusion:- Applying the rationale of above court ruling, submission of SIPL for condonation of delay while filing an appeal to High Court does not constitute "sufficient cause".

Readers Note:

SETTLEMENT OF CASES

Case Study

Sandeep Singh v. UOI [2017] 393 ITR 77

Supreme Court

Mr. Sandeep Singh is a dealer in real estate at Amritsar. A search was conducted on August 21, 2009 at his business and residential premises under section 132(1) subsequent to which he filed an application before the Settlement Commission under section 245C(1). The case was settled before the Settlement Commission on December 12, 2014. He was also granted immunity from prosecution subject to payment of sums due. However, he was unable to pay the amount due by the stipulated date. He sought an extension for 14 months but was only given time until July 31, 2015. Therefore, he filed a writ petition before the High Court seeking quashing/modification of the Settlement Commission's order granting partial extension of time. By the time the matter was heard, he had paid off all pending amounts. Whether payment of sums due, after the deadline stipulated by the Settlement Commission, would result into withdrawal of immunity from prosecution?

Issue involved:- Whether payment of sums due, after the deadline stipulated by the Settlement Commission, would save the petitioner from withdrawal of immunity from prosecution?

Provisions Applicable:- Section 245H of the Act.

Analysis/observation:- The Supreme Court explained that in case payments are not made within the time granted by the Settlement Commission or in case the person fails to comply with any other condition, subject to which the immunity was granted, the immunity shall stand withdrawn.

It is not in dispute that all payments were made by the assessee on January 20, 2016 before approaching the Supreme Court. Though the time originally granted was only up to July 31, 2015, all sums having been paid now, there is no need to relegate (transfer) the assessee to the Settlement Commission. Settlement Commission has the power to extend the timelines. Hence, in the instant case, it shall be taken that the assessee has made the payments within the time granted under section 245H(1A).

Conclusion:- The Supreme Court held that the assessee having cleared all taxes due vide order of Settlement Commission, albeit (although) after stipulated deadline, is immune from prosecution.

Readers Note:

Case Study

K. Lakshmansa and Co. v. CIT and Anr [2017] 399 ITR 657

Supreme Court

K. Lakshmansa and Co. approached the Settlement Commission for waiver of interest under sections 234A to 234C of the Income-tax Act, 1961. The Settlement Commission partially waived the interest which resulted into refund. The assessee requested to grant interest on refund under section 244A of the Act. However, Settlement Commission refused on the grounds that (i) Section 244A does not provide for payment of interest in such cases and (ii) the Settlement Commission has power to waive interest at its discretion but does not have power to provide for payment of interest under section 244A. Whether the assessee is entitled to interest on such refund?

Issue involved:- When refund is awarded by the Settlement Commission at its discretion, is there a right to receive interest on the same under section 244A?

Provisions Applicable:- Section 244A of the Act.

Analysis/observation:- The Supreme Court observed that the right to claim refund is automatic once the statutory provisions have been complied with. The statutory obligation to refund, being non-discretionary, carries with it the right to interest. Section 244A is clear and plain – it grants a substantive right of interest and is not procedural. Under section 244A, it is enough if the refund becomes due under the Income-tax Act, 1961 in which case the assessee shall, subject to the provisions of that section, be entitled to receive simple interest. The expression “due” only means that a refund becomes due pursuant to an order under the Act which either reduces or waives tax or interest. It does not matter that the interest being waived is discretionary in nature; the moment that discretion is exercised and refund becomes due consequently, a concomitant right to claim interest springs into being in favour of the assessee.

Conclusion:- The assessee has a right to receive interest on such refund under section 244A of the Act.

Readers Note:



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