CHAPTER 9

ASSESSMENT OF VARIOUS ENTITIES

LEARNING OUTCOMES

After studying this chapter, you would be able to -

- **compute** the total income of a company applying general provisions *vis-à-vis* special tax regimes under section 115BAA or 115BAB and determine the optimum tax liability;
- **advise** the company whether or not to opt for the special tax regime under section 115BAA;
- **examine** whether alternate minimum tax (AMT) would be applied in the case of persons other than companies; and **compute** AMT and determine AMT credit to be carried forward;
- **compute** the total income of a firm and its tax liability; and **determine** the liability of partners of a firm and LLP on dissolution;
- **compute** total income and tax liability of a co-operative society applying general provisions *vis-à-vis* special tax regimes under section 115BAD or 115BAE and determine the optimum tax liability;
- **advise** the co-operative society whether or not to opt for the special tax regime under section 115BAD;
- **compute** the total income of an individual, HUF, AOPs/BoIs as per the default regime under section 115BAC *vis-à-vis* normal provisions of the Income-tax Act, 1961 and determine the optimum tax liability;
- **examine** the incidence of taxation on mutual concerns.

CHAPTER OVERVIEW

Taxation of companies

- Total income and tax liability as per normal provisions of Act including MAT
- Total income and tax liability as per concessional tax regimes under section 115BAA or 115BAB, as the case may be

Special provisions relating to shipping companies

Alternate Minimum Tax for persons other than companies

Taxation of firms/LLPs and their partners

Taxation of Co-operative Societies (including concessional tax regimes u/s 115BAE or 115BAD)

Taxation of other entites

- Default Regime u/s 115BAC
- Taxation of Individuals
- Taxation of HUF
- Taxation of AOPs/BOIs and their members

Taxation of Mutual Concerns

Taxation of Local Authority

Tax planning considerations in relation to business

Taxation of life insurance business

Tax on income from GDR

Tax on income from transfer of carbon credits

9.1 TAXATION OF COMPANIES

(1) Meaning of 'Company' for purposes of income-tax

Under the Income-tax Act, 1961, the term "Company" has a much wider meaning than what has been given to it under the Companies Act. The company is considered as a 'person' for all purposes of assessment proceedings [Section 2(31)(iii)].

Section 2(17) of the Income-tax Act, 1961 defines a company for income-tax purposes. Accordingly, 'company' means –

(i) any Indian company as defined in section 2(26); or

(ii) any body corporate incorporated by or under the laws of a country outside India, i.e., any foreign company; or

(iii) any institution, association or body which is/was assessable or was assessed as a company for any assessment year under the Indian Income-tax Act, 1922 or for any assessment year commencing on or before 1.4.1970 under the present Act; or

(iv) any institution, association, or body, whether incorporated or not and whether Indian or non-Indian, which is declared by a general or special order of the CBDT to be a company.

Such institution, association etc. shall be deemed to be a company only for such assessment year(s) as may be specified in the CBDT's order.

(2) Classes of Companies

♦ **Domestic and Foreign Company:** Companies can be classified into two categories, viz. (1) Domestic company and (2) Foreign company.

(1) **Domestic company** means

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

Indian Company [Section 2(26)] - A company has to satisfy the following two conditions so that it can be regarded as an Indian company –

(a) the company should have been formed and registered under Companies Act, 1956[1]

(b) the registered office or the principal office of the company should be in India.

The expression 'Indian Company' also includes the following provided their registered or principal office is in India:

(i) Company formed and registered under any law in force in any part of India, excluding Jammu and Kashmir and specific Union territories;

(ii) Corporation established by or under a Central, State, or Provincial Act, such as Financial Corporation or State Road Transport Corporation;

(iii) Institution, association, or body declared by the Board to be a company under section 2(17)(iv);

(iv) Company formed and registered under any law in force in Jammu and Kashmir;

(v) Company formed and registered under any law in force in Union territories like Dadra and Nagar Haveli, Daman and Diu, Pondicherry, or the State of Goa.

Prescribed arrangements for the declaration and payment of dividends within India [Rule 27]: The arrangements referred to in sections 194 and 236 to be made by a company for declaration and payment of dividends (including dividends on preference shares) within India are as follows:

(i) The share register of the company concerned for all its shareholders shall be maintained regularly at its principal place of business within India in respect of any assessment year from a date not later than 1st April of such year.

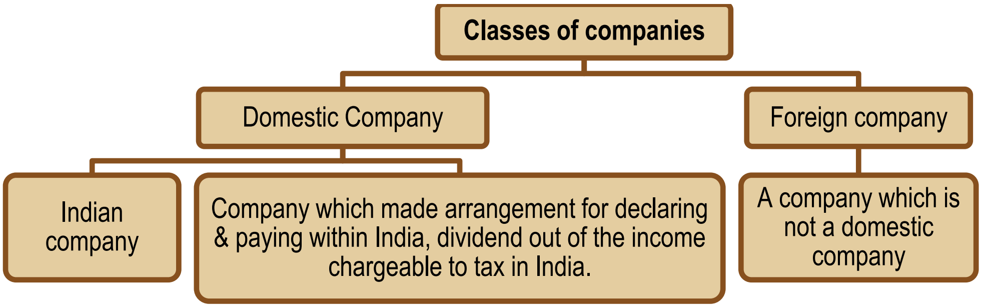
(ii) The general meeting for passing the accounts of the previous year relevant to the assessment year and for declaring any dividends in respect thereof shall be held only at a place within India.

(iii) The dividends declared, if any, shall be payable only within India to all the shareholders.

It is obligatory for Indian companies to make the prescribed arrangements stated above; non-Indian companies will be treated as domestic companies only if they make the prescribed arrangements for the declaration and payment of dividends in India.

[1]The Companies Act, 2013

(2) **Foreign Company:** A company which is not a domestic company is a foreign company [Section 2(23A)].



- **Closely held and widely held Company:** Domestic companies are again divided into broad groups, viz

  (1) companies in which public are substantially interested - 'Widely-held companies'

  (2) companies in which public are not substantially interested - 'Closely held companies'

  <u>**Widely Held Company (Company in which public are substantially interested):**</u> A company is considered to have substantial public interest if it meets any of the following criteria as outlined in section 2(18) of the Income-tax Act, 1961:

  (i) Government or RBI Ownership or participation: A company owned by the Central or State Government or the Reserve Bank of India (RBI), or where at least 40% of the shares are held (whether singly or taken together) by the Government or the RBI or a corporation owned by the RBI.

  (ii) Company registered under section 25 of the Companies Act, 1956[3]: A company registered under section 25 of the Companies Act, 1956[2], which is formed to promote commerce, art, science, education, research, social welfare, charity, environmental protection, etc., and does not distribute dividends to their members.

  (iii) Companies with No Share Capital and declared by the CBDT: A company which does not have share capital and is declared by the CBDT to be a company in which the public are substantially interested for specified assessment years.

  (iv) Mutual Benefit Finance Company (Nidhi or Mutual Benefit Society): A company that primarily accept deposits from its members and is declared by the Central Government under Section 620A of the Companies Act, 1956, to be a *Nidhi* or Mutual Benefit Society.

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[2] Section 8 of the Companies Act, 2013

(v) **Cooperative Society ownership:** A company whose equity shares carrying at least 50% of the voting power are unconditionally allotted or acquired and were beneficially held by one or more cooperative societies throughout the relevant previous year.

(vi) **Public Limited Company:** A company which is not a private company as defined in the Companies Act, 1956[3] and which fulfills any of the following conditions:

- its equity shares were listed in a recognized stock exchange in India as on the last day of the relevant previous year; or
- its equity shares carrying at least 50% (40% in case of an Indian company in ship construction business or in the manufacture or processing of goods or in mining or in generation or distribution of electricity or any other form of power) voting power have been unconditionally allotted to or acquired by and should have been beneficially held throughout the relevant previous year by

  (a) Government or

  (b) a Statutory Corporation or

  (c) a company in which public are substantially interested or

  (d) any wholly owned subsidiary of company mentioned in (c).

Closely Held Company (Company in which public are not substantially interested): Any company that does not meet the criteria for being classified as widely held company is considered closely held company. Thus, all private limited companies will be treated as companies in which public are not substantially interested.

Relevance of the above classification:

(1) The distinction between domestic and foreign companies is significant owing to, *inter alia*, the rates of tax.

Domestic companies are taxed at

- 25% - where total turnover or gross receipt in the previous year ***2023-24*** does not exceed ₹ 400 crore
- 30% - in any other case

Section 406 of the Companies Act, 2013[3]

Foreign companies are taxed at $\boxed{35\%}$. However, in respect of specified royalties and fees for technical services received from Government or an Indian concern in pursuance of an agreement, approved by the Central Government, made by the foreign company with the Government or Indian concern between 1.4.1961 and 31.3.1976 (in case of royalties) and between 1.3.1964 and 31.3.1976 (in case of FTS), the rate of tax is 50%.

Surcharge

Surcharge@7% of the tax payable is leviable in the case of domestic companies and @2% of tax payable in the case of foreign companies if the total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore.

Surcharge@12% of the tax payable is leviable in the case of domestic companies and @5% of tax payable in the case of foreign companies if the total income exceeds ₹ 10 crore.

Option available with domestic companies to opt for concessional rates of tax

Section 115BAA provides for concessional rate of tax **@22% (plus surcharge@10% and HEC@4%) for domestic companies**, subject to certain conditions, like non-availability of profit-linked deductions and investment-linked tax deduction under the Act, non-availability of deduction for contribution to research and development, additional depreciation etc. Domestic Companies **have to exercise the option** to be governed by section 115BAA. Once the company exercises such an option under section 115BAA in a year, it would continue to be governed by the special provision u/s 115BAA thereafter and cannot opt for regular provisions in any subsequent year.

Section 115BAB provides for concessional rate of tax **@15% (plus surcharge@10% plus HEC@4%) to manufacturing or electricity generating domestic companies set up and registered on or after 1.10.2019, and commences manufacturing or generating electricity on or before 31.3.2024**, subject to certain conditions, like non-availability of profit-linked deductions and investment-linked tax deduction under the Act, non-availability of deduction for contribution to research and development, additional depreciation etc. The option for section 115BAB could be exercised by the domestic companies in the **very first year** in which the **eligible company is set up**, failing which it cannot exercise such an option in the future years. **Accordingly, companies who have already opted for concessional tax under section 115BAB will be governed by the provisions of section 115BAB and a fresh option cannot**

be exercised under section 115BAB from A.Y. 2025-26 onwards. The company who has exercised such an option under section 115BAB, it would continue to be governed by the special provisions u/s 115BAB thereafter and cannot opt for regular provisions in any subsequent year.

It may be noted that companies exercising options under section 115BAA or section 115BAB are not liable to minimum alternate tax under section 115JB.

These two sections, namely sections 115BAA and 115BAB have been detailed in the upcoming paragraphs.

(2) The question as to whether a company is one in which public are substantially interested or not is relevant for application of certain provisions which are applicable only to closely held company.

There are certain special provisions which are applicable only to companies in which public are not substantially interested. Examples of such special provisions are as follows:

S. No.	Section	Provision
1	2(22)(e)	Advance or loan by a closely held company - deemed dividend
2	68	Taxation of sum received by closely held company as share application money, share capital, share premium and the explanation offered by company is not satisfactory
3	79	Carry forward and set-off of losses in case of closely held companies
4	179	Liability of directors of private company

(3) 115BAB and 115BAA providing for concessional rate of tax in respect of certain domestic companies

Sections 115BAB and 115BAA provide for concessional rates of tax and exemption from minimum alternate tax (MAT) in respect of certain domestic companies. The provisions of these two new sections are tabulated hereunder –

(1)	(2)	(3)	(4)
	Particulars	**Section 115BAB**	**Section 115BAA**
1.	**Applicability**	Domestic manufacturing company/Electricity generation company	Any domestic company
2.	**Rate of tax**	15%	22%
3.	**Rate of surcharge**	10%	10%
4.	**Effective rate of tax (including surcharge & HEC)**	**17.16%** [Tax@15% (+) Surcharge@10% (+) HEC@4%]	**25.168%** [Tax@22% (+) Surcharge@10% (+) HEC@4%]
5.	**Applicability of MAT**	Not applicable	Not applicable
6.	**Manner of computation of tax liability**		
	Income on which concessional rate of tax is applicable	The rate of tax (i.e., **17.16%**) is applicable in respect of income derived from or incidental to manufacturing or production of an article or thing or generation of electricity. **[Read with point no. 11 below, wherein the rate of 34.32% (i.e., Tax@30% + surcharge@10% + HEC@4%) would be applicable in specified circumstance]**	The rate of tax (i.e., **25.168%)** is notwithstanding anything contained in the Income-tax Act, 1961, but subject to the provisions of Chapter XII, other than section 115BA and 115BAB.
	Rate of tax on income covered under Chapter XII [For example, long-term capital gains chargeable to tax u/s 112 and 112A, short-term capital gains chargeable to tax u/s 111A]	Such income would be subject to tax at the rates mentioned in the said sections in Chapter XII. Surcharge@10% would be levied on tax computed on such income. HEC@4% would be levied on the income-tax *plus* surcharge.	Such income would be subject to tax at the rates mentioned in the said sections in Chapter XII. Surcharge@10% is leviable on tax computed on such income. HEC@4% would be levied on the income-tax *plus* surcharge.

(1)	(2)	(3)		(4)
	Particulars	**Section 115BAB**		**Section 115BAA**
	Rate of tax on other income in respect of which no specific rate of tax is provided in Chapter XII	The applicable tax rate is **25.168% (i.e., tax@22%, *plus* surcharge @10% *plus* HEC@4%),** if such income has neither been derived from nor is incidental to manufacturing or production of an article or thing or generating electricity (For example, income from house property and income from other sources). In respect of such income, **no deduction or allowance in respect of any expenditure or allowance** shall be allowed in computing such income.		The applicable tax rate is **25.168% (i.e., tax@22% *plus* surcharge@10% *plus* HEC@4%).** There is, however, **no restriction regarding claim of any deduction or allowance** permissible under the relevant provisions of the Act.
	Rate of tax on STCG derived from transfer of a capital asset on which no depreciation is allowable under the Act	The applicable rate of tax is **25.168% (i.e., tax@22%, *plus* surcharge@10% *plus* HEC@4%).** There is, however, no restriction regarding claiming of deduction or allowance in this regard.		The applicable rate of tax is **25.168% i.e., tax @22%, *plus* surcharge @10% *plus* cess@4%.** There is no restriction regarding claiming of deduction or allowance in this regard.
7.	**Conditions to be fulfilled for availing concessional rate of tax and exemption from MAT**			
	Conditions to be fulfilled for availing concessional rate of tax and exemption from MAT	**(i)**	The company should be **set-up and registered on or after 1.10.2019.**	No time limit specified. Both existing companies and new companies can avail benefit.
		(ii)	It should **commence manufacturing or production of an article or thing or business of generating electricity on or before $\boxed{31.3.2024.}$**	Need not be a manufacturing or a production company
		(iii)	It should **<u>not</u> be formed by splitting up or the reconstruction of a business already in existence** (except in case	No similar condition has been prescribed

(1)	(2)	(3)		(4)
	Particulars	**Section 115BAB**		**Section 115BAA**
			of a company, business of which is formed as a result of the re-establishment, reconstruction or revival by the person of the business of any undertaking referred to in section 33B in the circumstances and within the period specified therein)	
		(iv)	It does **not** use any machinery or plant previously used for any purpose **[Refer Note at the end]**	No similar condition has been prescribed
		(v)	It does **not** use any building previously used as a hotel or a convention centre [meanings assigned in section 80-ID(6)] in respect of which deduction u/s 80-ID has been claimed and allowed.	No similar condition has been prescribed
		(vi)	It should **not** be 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. ***Note*** *– Business of manufacture or production of any article or thing does* ***not*** *include business of –*	No similar condition has been prescribed

(1)	(2)	(3)	(4)
	Particulars	**Section 115BAB**	**Section 115BAA**
		(1) Development of computer software in any form or in any media *(2) Mining* *(3) Conversion of marble blocks or similar items into slabs* *(4) Bottling of gas into cylinder* *(5) Printing of books or production of cinematograph films* *(6) Any other business as may be notified by the Central Govt. in this behalf.*	
		Note *- If difficulty arises regarding fulfilment of conditions listed in (iv) to (vi) above, the CBDT may, with the approval of the Central Government, issue guidelines for the purpose of removing difficulty and to promote manufacturing or production of article or thing using new plant and machinery.* *Every guideline issued by the CBDT has to be laid before each House of Parliament, and shall be binding on the person, and the income-tax authorities subordinate to it.*	
8.	**Common conditions for both sections for**	In case of a company opting for either section 115BAA or 115BAB, the total income should be computed -	

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<tr><th></th><th>Particulars</th><th colspan="3">Section 115BAB</th><th>Section 115BAA</th></tr>
<tr><td rowspan="10"></td><td rowspan="10">availing the concessional rate of tax and exemption from MAT</td><td rowspan="10">(i)</td><td colspan="3">without providing for deduction under any of the following sections:</td></tr>
<tr><td>Section</td><td colspan="2">Provision</td></tr>
<tr><td>10AA</td><td colspan="2">Exemption of profits and gains derived from export of articles or things or from services by an assessee, being an entrepreneur from his Unit in SEZ.</td></tr>
<tr><td>32(1)(iia)</td><td colspan="2">Additional depreciation @20%, as the case may be, of actual cost of new plant and machinery acquired and installed by manufacturing undertakings.</td></tr>
<tr><td>33AB</td><td colspan="2">Deduction@40% of profits and gains of business of growing and manufacturing tea, coffee or rubber in India, to the extent deposited with NABARD in accordance with scheme approved by the Tea/Coffee/Rubber Board.</td></tr>
<tr><td>33ABA</td><td colspan="2">Deduction@20% of the profits of a business of prospecting for, or extraction or production of, petroleum or natural gas or both in India, to the extent deposited with SBI in an approved scheme or deposited in Site Restoration Account.</td></tr>
<tr><td>35(1)(ii)/ (iia)/(iii)</td><td colspan="2">Deduction for payment to any research association, company, university etc. for undertaking scientific research or social science or statistical research.</td></tr>
<tr><td>35(2AA)</td><td colspan="2">Deduction of payment to a National Laboratory or University or IIT or approved specified person for scientific research</td></tr>
<tr><td>35(2AB)</td><td colspan="2">Deduction of in-house scientific research expenditure incurred by a company engaged in the business of bio-technology or in the business of manufacture or production of an article or thing.</td></tr>
<tr><td>35AD</td><td colspan="2">Investment-linked tax deduction for specified businesses.</td></tr>
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<tr><td></td><td>35CCC</td><td>Deduction of expenditure incurred on notified agricultural extension project</td></tr>
<tr><td></td><td>35CCD</td><td>Deduction of expenditure incurred by a company on notified skill development project.</td></tr>
<tr><td></td><td>80C to 80U</td><td>Deductions from gross total income under Chapter VI-A other than the provisions of section 80JJAA or section 80M.</td></tr>
<tr><td>(ii)</td><td colspan="2">without set-off of any loss or allowance for unabsorbed depreciation deemed so u/s 72A, where such loss or depreciation is attributable to any of the deductions listed in (i) above [Such loss and depreciation would be deemed to have been already given effect to and no further deduction for such loss shall be allowed for any subsequent year]</td></tr>
<tr><td>(iii)</td><td colspan="2">by claiming depreciation u/s 32 determined in the prescribed manner (i.e., in respect of depreciation of any block of assets entitled to more than 40% shall be restricted to 40% on the written down value of such block of assets). However, additional depreciation u/s 32(1)(iia) cannot be claimed.</td></tr>
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<tr><td></td><td></td><td colspan="2"><u>Note</u> – <u>Additional points relevant in the context of section 115BAA</u>:

(1) In case of a company opting for section 115BAA, total income should be computed without set-off of any loss carried forward or depreciation from any earlier assessment year, where such loss or depreciation is attributable to any of the deductions listed in (i) above [Such loss and depreciation would be deemed to have been already given effect to and no further deduction for such loss or depreciation shall be allowed for any subsequent year]

(2) In the case of a person having a Unit in the IFSC, referred to in section 80LA(1A), which has exercised option for section 115BAA, deduction u/s 80LA would be allowed subject to fulfilment of the conditions specified in that section.

(3) Since there is no time line within which option under section 115BAA can be exercised, a domestic company</td></tr>
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(1)	(2)	(3)	(4)
	Particulars	Section 115BAB	Section 115BAA
			having brought forward losses and depreciation on account of deductions listed in (i) above may, if it so desires, postpone exercise the option under section 115BAA to a later assessment year, after set off of the losses and depreciation so accumulated.
9.	**Failure to satisfy conditions**	On failure to satisfy the conditions mentioned in point no. 7 and 8 above in any P.Y., the option exercised would be invalid in respect of the assessment year relevant to that previous year and subsequent assessment years; Consequently, the other provisions of the Act would apply to the person as if the option had not been exercised for the assessment year relevant to that previous year and subsequent assessment years. ***Note*** – *Where option exercised under section 115BAB is rendered invalid due to violation of conditions stipulated in point no.7 [(iv) to (vi)] above, such person may exercise option under section 115BAA.*	On failure to satisfy the conditions mentioned in point no. 8 above in any P.Y., the option exercised would be **invalid** in respect of the assessment year relevant to that previous year and subsequent assessment years; Consequently, the other provisions of the Act would apply to the person as if the option had not been exercised for the assessment year relevant to that previous year and subsequent assessment years.
10.	**Availability of set-off of MAT credit brought forward from earlier years**	No brought forward MAT credit	Brought forward MAT credit cannot be set-off against income u/s 115BAA. ***Note*** - *If a company has b/f MAT credit, it can first exhaust the MAT credit, and thereafter opt for section 115BAA in a subsequent previous year.*
11.	**Adjustments for transactions with persons having close connection**	If the Assessing Officer opines that the course of business between the company and any other person having close connection therewith is so	No such requirement to make any adjustment

(1)	(2)	(3)	(4)
	Particulars	**Section 115BAB**	**Section 115BAA**
		arranged that the business transacted between them produces more than the ordinary profits to the company, he is empowered to take into account the amount of profits as may be reasonably deemed to have been derived therefrom, while computing profits and gains of such company.	
		In case the arrangement referred above involves a specified domestic transaction referred to in section 92BA, then, the amount of profits from such transaction would be determined by considering the arm's length price (ALP). **The amount, being profits in excess of the amount of the profits determined by the Assessing Officer, shall be deemed to be the income of the person.** **The income-tax on the income so deemed shall be subject to tax @ 34.32% (i.e., tax @ 30% + surcharge @10% +HEC @ 4%).** ***Note** – The scope of "specified domestic transaction" referred to in section 92BA has been expanded to include within its ambit, any business transacted between such persons with close connection, where one such person is a company claiming benefit under section 115BAB.*	
12.	**Exercise of option by the company**	The beneficial provisions of this section would apply only if	The beneficial provisions of this section would apply if

(1)	(2)	(3)	(4)
	Particulars	**Section 115BAB**	**Section 115BAA**
	within the prescribed time	option is exercised in the prescribed manner on or before the due date u/s 139(1) for furnishing **the first of the returns of income for any previous year** relevant to assessment year or any subsequent assessment year. Such option, once exercised, would apply to subsequent assessment years. Further, once the option has been exercised for any previous year, it **cannot be subsequently withdrawn** for the same or any other previous year. ***Notes** – (1) The option has to be exercised at the time of furnishing the **first of the returns of income** for any previous year. **Accordingly, companies who have already opted for concessional tax under section 115BAB will be governed by the provisions of section 115BAB and a fresh option cannot be exercised under section 115BAB from A.Y. 2025-26 onwards.*** *(2) In case of amalgamation, the option exercised u/s 115BAB shall remain valid in the case of the amalgamated company only and if the conditions mentioned in point no. (7) and (8) are continued to be satisfied by such company.*	option is exercised in the prescribed manner on or before the due date u/s 139(1) for furnishing the return of income for any previous year relevant to assessment year or any subsequent A.Y. Such option, once exercised, would apply to subsequent assessment years. Further, once the option has been exercised for any previous year, it **cannot be subsequently withdrawn** for the same or any other previous year. ***Note** – The option can be exercised even in a later year, but once exercised, cannot be withdrawn subsequently.* *Further, where the person exercises option under section 115BAA, the option under section 115BA may be withdrawn.*

***Note** - For the purpose of point no.7(iv) in column (3) of the above table in relation to a company exercising option under section 115BAB, any machinery or plant which was used outside India by* *any other person shall not be regarded as machinery or plant previously used for any purpose, if all the following conditions are fulfilled, namely:—*

(a) such machinery or plant was not, at any time previous to the date of the installation, used in India;

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

(c) no deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under the provisions of the Income-tax Act, 1961 in computing the total income of any person for any period prior to the date of installation of the machinery or plant by the person.

Further, where in the case of a person, any machinery or plant or any part thereof previously used for any purpose is put to use by the company and the total value of the machinery or plant or part so transferred does not exceed 20% of the total value of the machinery or plant used by the company, then, the condition specified that the company does not use any machinery or plant previously used for any purpose would be deemed to have been complied with.

(4) Minimum Alternate Tax on companies [Section 115JB]

(i) Applicability of MAT

As per section 115JB(1), in case of company (domestic or foreign), if the income-tax payable on the total income computed under the Income-tax Act, 1961 is ***less*** than, **15%** of its book profit, such book profit shall be deemed to be the total income of the assessee and the tax payable by the assessee on such total income shall be the amount of income-tax at the rate of **15%** (add surcharge, if applicable, i.e., 7% for domestic companies and 2% for foreign companies, where the total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore, and 12% for domestic companies and 5% for foreign companies where the total income exceeds ₹ 10 crore). Further, health and education cess @4% shall be added on the aggregate of income-tax and surcharge.

(ii) Maintenance of statement of profit and loss [Section 115JB(2)]

(a) Every company other than a company referred to in section 115JB(2)(b) shall for the purpose of this section, prepare its statement of profit and loss for the relevant previous year in accordance with the provisions of Schedule III to the Companies Act, 2013 **[Section 115JB(2)(a)].**

(b) Insurance companies, banking companies, companies engaged in generation or supply of electricity or any other class of company for which a form of financial statement has been specified in or under the Act governing such class of company, shall for the purposes of this section, prepare its statement of profit and loss for the relevant previous year in accordance with the provisions of the Act governing such company **[Section 115JB(2)(b)].**

(c) The section also specifies that the statement of profit and loss for the relevant previous year has to be drawn in accordance with Schedule III to the Companies Act, 2013. Further, while preparing the annual accounts-

(i) the accounting policies,

(ii) the accounting standards followed for preparing such accounts, including statement of profit and loss

(iii) the method and rates for calculating depreciation

shall be the same as have been adopted for the purpose of preparing such accounts including statement of profit and loss and laid before the company at its annual general meeting.

(d) Where the financial year adopted by the company under the Companies Act, 2013 is different from the previous year under the Income-tax Act, 1961, the accounting policies, accounting standards and methods and rates adopted for calculating depreciation shall correspond to the accounting policies followed for preparing such accounts including statement of profit and loss for the financial year.

(iii) Computation of book profit [*Explanation 1* to section 115JB(2)]

For computing the book profit, the **profit shall be increased** by the following amounts, if the amount referred in (a) to (i) is **debited to** the statement of profit and loss

(a) **Income-tax:** Income-tax paid or payable, and the provision therefor;

[It may be noted that income-tax includes –

(1) interest;

(2) surcharge;

(3) health and education cess (*Explanation 2* to section 115JB)].

(b) **Amount carried to Reserves:** Amount carried to any reserves, by whatever name called;

(c) **Provisions:** Amounts set aside to provisions for meeting liabilities other than ascertained liabilities;

(d) **Provisions for losses of subsidiary companies:** Amount of provision for losses of subsidiary companies;

(e) **Dividends:** Amount of dividends paid or proposed; or

(f) **Expenditure relatable to exempt income:** Amount of expenditure relatable to any income to which section 10 or sections 11 or 12 apply;

(fa) **Expenditure relatable to share of an assessee in the income of an AOP or BOI:** Amount of expenditure relatable to income, being share of the assessee in the income of an AOPs or BOIs, on which no income-tax is payable in accordance with the provisions of section 86;

(fb) **Expenditure relatable to income accruing to foreign company:** 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, dividend, royalty, or fees for technical services chargeable to tax at the rate or rates specified in Chapter XII i.e., section 115A

if the income-tax payable thereon in accordance with the provisions of the Act, other than the provisions of this Chapter, is at a rate less than **15%**;

(fc) **Notional loss on the units of business trust:** 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 that trust; or
- notional loss resulting from any change in carrying amount of said units or
- loss on transfer of such units

(fd) **Amount of expenditure relatable to income referred under section 115BBF:** The amount or amounts of expenditure relatable to income by way of royalty in respect of patent chargeable to tax under section 115BBF;

(g) **Depreciation:** The amount of depreciation;

(h) **Deferred tax:** The amount of deferred tax and provision therefore;

(i) **Provision for diminution in the value of any asset:** The amount set aside as provision for diminution in the value of any asset.

(j) **Amount standing in the revaluation reserve:** The profit shall also be increased by the amount standing in revaluation reserve relating to the revalued asset on the retirement or disposal of such asset, in case the same is not credited to the profit and loss account.

(k) **Amount of gain arise on transfer units of business trust:** When units of business trust are actually transferred, the amount of gain on such transfer has to be added to compute the book profit, since notional gains on transfer of share of a special purpose vehicle to a business trust in exchange for the units of the business trust and notional gains resulting from change in carrying amount of such units would have been deducted to compute book profit. The amount of gain on such transfer, if any, credited to statement of profit and loss in the year of transfer will also be reduced.

In a case where the shares are carried at cost: The amount of gain has to be computed by taking into consideration the cost of shares exchanged with the units of the business trust.

In a case where the shares are carried at a value other than the cost through statement of profit and loss: The carrying amount of shares at the time of exchange would be taken into consideration for computing the amount of gain.

The profit shall be reduced by the following amounts:

(i) **Amount withdrawn from any reserve:** The amount withdrawn from any reserve or provision, if any such amount is credited to the statement of profit and loss.

However, the amount withdrawn from reserves/provisions shall not be reduced from the book profit unless the book profit of that year has been increased by those reserves/ provisions;

(ii) **Exempt income:** Amount of income to which section 10 or sections 11 or 12 apply, if such amount is credited to the statement of profit and loss;

(iia) **Depreciation:** The amount of depreciation debited to the statement of profit and loss (excluding the claim of depreciation on account of revaluation of assets);

(iib) **Amount withdrawn from the revaluation reserve:** The amount withdrawn from the revaluation reserve and credited to the statement of profit and loss, to the extent it does not exceed the amount of depreciation on revaluation of assets;

(iic) **Share of the assessee in the income of an AOPs or BOIs:** The amount of income, being the share of the assessee in the income of an AOPs or BOIs, 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;

(iid) **Income accruing to foreign company:** The amount of 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, dividend, royalty, or fees for technical services chargeable to tax at the rate or rates specified in Chapter XII i.e., section 115A,

if such income is credited to the statement of profit and loss and the income-tax payable thereon in accordance with the provisions of the Income-tax Act, 1961 (including DTAAs), other than the provisions of Chapter XII-B, is at a rate less than **15%**.

For example, in case of foreign companies, dividend is taxable @20% as per section 115A. The adjustment in respect of dividend received by a foreign company on its investment in India and expenditure relatable thereto is required to be made for the purposes of calculation of book profit in case the tax payable on such dividend income is less than 15% on account of concessional tax rate provided in the applicable Double Taxation Avoidance Agreement (DTAA).

(iie) **Notional gain on the units of business trust:** The amount representing –

(A) the notional gain on transfer of a capital asset, being a share of a SPV to a business trust in exchange of units allotted by the business trust;

(B) notional gain resulting from any change in carrying amount of said units;

(C) gain on transfer of such units,

if any, credited to statement of profit and loss;

(iif) **Loss on transfer of units:** The amount of loss on transfer of units acquired in exchange of shares of SPV computed by taking into account the cost of the shares exchanged with the units, where the shares are carried at cost. In case shares are carried at a value other than cost through statement of profit and loss, the amount of loss on transfer of such units has to be computed by taking into account the carrying amount of the shares at the time of exchange;

(iig) **Income by way of royalty taxable under section 115BBF:** The amount of income by way of royalty in respect of patent chargeable to tax under section 115BBF;

(iih) **Brought forward loss and unabsorbed depreciation:** Aggregate amount of unabsorbed depreciation and loss brought forward in case of a –

(A) company, and its subsidiary and the subsidiary of such subsidiary, where, the Tribunal, on an application moved by the Central Government under section 241 of the Companies Act, 2013 has suspended the Board of Directors of such company and has appointed new directors who are nominated by the Central Government under section 242 of the said Act;

(B) 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.

It may be noted that loss does not include depreciation.

A company would be a subsidiary of another company if such other company holds more than half in the nominal value of equity share capital of the company.

(iii) **Brought forward loss or unabsorbed depreciation in case of other companies:** Amount of brought forward loss or unabsorbed depreciation, whichever is less, in case of other companies as per books of account.

The loss shall not include depreciation; if either the figure of brought forward loss or unabsorbed depreciation is "NIL", no deduction will be allowed from the book profit of the relevant year;

(vii) **Profits of sick industrial company:** The amount of profits of a sick industrial company (BIFR company) commencing from the previous year in which the company became sick and ending with the assessment year during which the entire net worth of such company becomes equal to or exceeds the accumulated losses. For this purpose, "net worth" shall have the same meaning as assigned under section 3(1)(ga) of the Sick Industrial Companies (Special Provisions) Act, 1985.

(viii) **Deferred tax:** The amount of deferred tax, if any such amount is credited to the statement of profit and loss.

(iv) Computation of Book Profit for Ind AS compliant companies:

The Central Government has notified the Indian Accounting Standards (Ind AS) which are converged with International Financial Reporting Standards (IFRS) and prescribed the Companies (Indian Accounting Standards) Rules, 2015 which lay down the roadmap for implementation of these Ind AS.

As the book profit based on Ind AS compliant financial statements is likely to be different from the book profit based on existing Indian GAAP, sub-sections (2A), (2B) and (2C) of section 115JB provides the framework for computation of book profit for Ind AS compliant companies in the year of adoption and thereafter.

Adjustment in the book profit due to adoption of Ind AS

- Annual Adjustment [Section 115JB (2A) & (2B)]
- Transitional adjustments at the convergence date [Section 115JB(2C)]

I. MAT on Ind AS compliant financial statement [Section 115JB(2A)]

In case of a company whose financial statements are drawn up in compliance with the Indian Accounting Standards (Ind ASs) specified in Annexure to the Companies (Indian Accounting Standards) Rules, 2015, the following additional adjustments shall be done to the book profit as computed above in point no. (iii) as per section 115JB(2) read with *Explanation 1* -

(a) increased by all amounts credited to other comprehensive income in the statement of profit and loss under the head "Items that will not be re-classified to profit or loss";

(b) decreased by all amounts debited to other comprehensive income in the statement of profit and loss under the head "Items that will not be re-classified to profit or loss";

However, no adjustment shall be made where the amount credited or debited to other comprehensive income under the head "Items that will not be re-classified to profit or loss", in respect of —

(i) Revaluation surplus for assets in accordance with the Indian Accounting Standards 16 and Indian Accounting Standards 38; or

(ii) Gains or losses from investments in equity instruments designated at fair value through other comprehensive income in accordance with the Indian Accounting Standards 109. **[First proviso to section 115JB(2A)]**

However, the book profit of the previous year, in which such asset or investment is retired, disposed, realised or otherwise transferred, shall be increased or decreased, as the case may be, by the amount or the aggregate of the amounts as referred to in the first proviso for the previous year or any of the preceding previous years and relatable to such asset or investment **[Second proviso to section 115JB(2A)].**

The other comprehensive income (OCI) includes certain items that will permanently be recorded in reserves and hence, never be reclassified to the statement of profit and loss included in the computation of book profits. These items shall be included in book profit for MAT purposes at the point of time as specified below-

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 every year as the re-measurements gains and losses arise
4	Any other item	To be included in book profits every year as the gains and losses arise

(c) Increased by amounts or aggregate of the amounts debited to the statement of profit and loss on distribution of non-cash assets to shareholders in a demerger in accordance with Appendix A of the Indian Accounting Standards 10;

(d) Decreased by all amounts or aggregate of the amounts credited to the statement of profit and loss on distribution of non-cash assets to shareholders in a demerger in accordance with Appendix A of the Indian Accounting Standards 10;

Appendix A of Ind AS 10 provides that any distributions of non-cash assets to shareholders 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.

II. **In case of demerger [Sub-section (2B)]:** In the case of a resulting company, 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 computation of book profit of the resulting company under this section.

III. **MAT on first time adoption [Section 115JB(2C)]:**

In case of Ind AS compliant company, the book profit of the year of convergence and each of the following four previous years, shall be further increased or decreased, as the case may be, by one-fifth of the **transition amount**.

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.

For the purposes of computation of book profits of the year of adoption and for adjustments, the amounts adjusted as on the opening date of the first year of adoption shall be considered.

Example: Companies which adopt IndAS with effect from 1st April 2025 are required to prepare their financial statements for the year 2025-26 as per the requirements of Ind AS. Such companies are also required to prepare an opening balance sheet as of 1st April 2024 and restate the financial statements for the comparative period 2024-25.

In such a case, the first-time adoption adjustments as of 31 March 2025 shall be considered for computation of MAT liability for previous year 2025-26 (Assessment year 2026-27) and thereafter.

Further, in this case, the five years period shall be previous years 2025-26, 2026-27, 2027-28, 2028-29 and 2029-30.

However, the book profit of the previous year in which the asset or investment referred to in sub clauses (B) to (E) of clause (iii) of the *Explanation* is retired, disposed, realised or otherwise transferred shall be increased or decreased, as the case may be, by the amount or the aggregate of the amounts referred to in the said sub-clause relatable to such asset or investment **[First proviso to section 115JB(2C)].**

Further, the book profit of the previous year in which the foreign operation referred to in sub clause (F) of clause (iii) of the *Explanation* is disposed or otherwise transferred, shall be increased or decreased, as the case may be, by the amount or the aggregate of the amounts referred to in the said sub-clause relatable to such foreign operations **[Second proviso to sub-section (2C)].**

Meaning of certain terms [*Explanation* to Section 115JB(2C)]

Clause	Term	Meaning
(i)	**Year of convergence**	the previous year within which the convergence date falls.
(ii)	**Convergence date**	the first day of the first Indian Accounting Standards reporting period as defined in the Ind AS 101.
(iii)	**Transition amount**	the amount or aggregate of the amounts adjusted in other equity (excluding capital reserve and securities premium reserve) on convergence date but not including the following: (A) Amount or aggregate of the amounts adjusted in the other comprehensive income on the convergence date which shall be subsequently re-classified to the profit and loss; (B) Revaluation surplus for assets in accordance with the Indian Accounting Standards 16 and Indian Accounting Standards 38 adjusted on the convergence date; (C) Gains or losses from investments in equity instruments designated at fair value through other comprehensive income in accordance with the Indian Accounting Standards 109 adjusted on the convergence date; (D) Adjustments relating to items of property, plant and equipment and intangible assets recorded at fair value as deemed cost in accordance with paragraphs D5 and D7 of the Indian Accounting Standards 101 on the convergence date;

		(E) Adjustments relating to investments in subsidiaries, joint ventures and associates recorded at fair value as deemed cost in accordance with paragraph D15 of the Indian Accounting Standards 101 on the convergence date; and (F) Adjustments relating to cumulative translation differences of a foreign operation in accordance with paragraph D13 of the Indian Accounting Standards 101 on the convergence date.

Transitional adjustments: Analysis

(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. These adjustments have to be made in the following manner:	
	(a)	The book profit of the year of convergence and the following four previous years shall be increased or decreased with the transitional adjustments recorded directly in Other Equity excluding capital reserve and securities premium reserve and excluding the amounts referred in (A) to (F) (in the definition of Transition Amount), on the convergence date.
	(b)	Those adjustments recorded in other comprehensive income referred in (A) above (in the definition of Transition Amount) 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, therefore these amounts are excluded from the transition amount.
	(c)	Those adjustments recorded in other comprehensive income referred in (B) and (C) (in the definition of Transition Amount) above 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 realisation/ disposal/ retirement or otherwise transferred
2	Gains and losses from investments in equity instruments designated at fair value through other	To be included in book profits at the time of realisation/ disposal/ retirement or otherwise transferred

		comprehensive income (Ind AS 109)	
	3	Remeasurements of defined benefit plans (Ind AS 19)	To be included in book profits every year as the re-measurements gains and losses arise
	4	Any other item	To be included in book profits every year as the gains and losses arise

(d) The other adjustments referred in (D), (E) and (F) (in the definition of Transition Amount) above shall be made in the following manner:

(I)	**Property, Plant and Equipment (PPE) and intangible assets at fair value as deemed cost [referred in (D)(in the definition of Transition Amount) above]** 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 realization/ disposal/ retirement of such assets shall be computed ignoring the aforesaid retained earnings adjustment.
II.	**Investments in subsidiaries, joint ventures and associates at fair value as deemed cost [referred in (E)(in the definition of Transition Amount) above]** 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.

		III.	**Cumulative translation differences [referred in (F) (in the definition of Transition Amount) above]** • 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 (recorded as other equity) 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)	Section 115JB of the Act already provides for adjustments on account of deferred tax and its provision. Any deferred tax adjustments recorded in Reserves and Surplus on account of transition to Ind AS shall also be ignored.		

(v) 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 [Circular No. 24/2017[4] dated 25.07.2017]

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.*

[4] The year in the FAQs have been modified considering that the transition to Ind AS is taking place in the P.Y. 2025-26.

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 April 2025 are required to prepare their financial statements for the year 2025-26 as per requirements of Ind AS. Such companies are also required to prepare an opening balance sheet as of 1st April 2024 and restate the financial statements for the comparative period 2024-25. In such a case, the first time adoption adjustments as of 31st March 2025 should be considered [i.e. the start of business on 1st April 2025 (or, equivalently, close of business on 31st March 2025)] for computation of MAT liability for previous year 2025-26 (Assessment year 2026-27) 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 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 F.Y. 2024-25 which was recognized in profit and loss account in F.Y. 2024-25 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 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 2023	*100*	*1000*	*900*
Depreciation @10% for F.Y. 2023-24	*10*	*100*	*90*
WDV as on 1 April 2024	*90*	*900*	*810*
Depreciation @10% for F.Y. 2024-25	*9*	*90*	*81*
WDV as on 1 April 2025	*81*	*810*	*729**
Sale value as on 1 April 2025	*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 2026-27 onwards?*

Answer: For assessment year 2026-27, the deduction of lower of depreciation or losses shall be allowed based on the position as on 31st March 2025. 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 2026 ending for Companies Act purposes and are required to transition to Ind AS will have to prepare financial statements for MAT purposes for F.Y. 2025-26 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 2025 and under Ind AS for 3 months thereafter. The transition amount will be calculated with reference to 1st January 2026.

(vi) Adjustment in tax payable on book profit u/s 115JB(1) on account of Advance Pricing Agreement (APA) under section 92CC or secondary adjustment under section 92CE [Section 115JB(2D)]: Where there is an increase in book profit of the previous year due to inclusion of past year(s) income in books of account on account of

(1) an APA entered into by the assessee under section 92CC; or

(2) secondary adjustment, required to be made under section 92CE, and

the assessee makes an application to the Assessing Officer in this behalf, the Assessing Officer shall recompute

- the book profit of the past year or years and
- tax payable, if any, by the assessee during the previous year under section 115JB(1),

in such manner as may be prescribed.

In such case, the provisions of section 154 [i.e., rectification of mistake apparent from record] would apply; and the period of four years would be reckoned from the end of the financial year in which the said application is received by the Assessing Officer.

Accordingly, Rule 10RB(1) has been inserted to provide that the tax payable by the assessee company under section 115JB(1), for the previous year, shall be reduced by the following amount:

(A-B) – (D-C)	
A	tax payable by the assessee company under section 115JB(1) on the book profit of the previous year including the past income. However, where no tax is payable under section 115JB(1) on book profit of that previous year including past income, the value of A would be deemed to be zero.
B	tax payable by the assessee company under section 115JB(1) on the book profit of the previous year after reducing the book profit with the past income. However, where no tax is payable under section 115JB(1) on the resultant figure, the value of B would be deemed to be zero.
C	Aggregate of tax payable by the assessee company under section 115JB(1) on the book profit of those past year or years to which the past income belongs. However, where no tax is payable under section 115JB(1) on the book profit of that year or years, the tax payable for that year or years would be deemed to be zero.
D	Aggregate of tax payable by the assessee company under section 115JB(1) on the book profit of past year or years, referred to in item C, after increasing the book profit with the relevant past income of such year or years. However, where no tax is payable under section 115JB(1) on the amount so increased, the tax payable for that year or years would be deemed to be zero.
It may be noted that if the value of (A-B)-(D-C) in the formula is negative, its value would be deemed to be zero.	
Meaning of past income [Rule 10RB(2)]	Past income means the amount of income of past year or years included in the book profit of the previous year on account of an APA entered into by the assessee under section 92CC or on account of secondary adjustment required to be made under section 92CE.
MAT credit to be reduced [Rule 10RB(3)]	The tax credit allowed to the assessee under section 115JAA would be reduced by the amount which is equal to the amount of reduction that has been allowed under Rule 10RB(1).

The adjustment in the book profit shall be made only if the assessee has not utilised the credit of tax paid in any subsequent assessment year under section 115JAA.

The provisions of this sub-section have been inserted w.e.f. A.Y. 2021-22. However, these provisions would also be applicable for the A.Y. 2020-21 or any earlier assessment year. However, no interest shall be payable to such assessee on the refund arising on account of re-computation of book profits of the previous year.

(vii) Compulsory filing of return of income and furnishing of report from Chartered Accountant

The section also provides that every company to which this section applies shall furnish, a report from a chartered accountant certifying that the book profit has been computed in accordance with the provisions of this section, on or before the specified date referred to in section 44AB (i.e., one month prior to the due date for filing return of income) or in response to a notice under section 142(1)(i), [Section 115JB(4)].

(viii) Allowability of carry forward of losses

In respect of the relevant previous year, the amounts determined under the provisions of section 32(2) or section 72(1)(ii) or section 73 or section 74 or section 74A(3), shall be allowed to be carried forward [Section 115JB(3)].

(ix) Applicability of other provisions of the Act

All other provisions of the Act shall apply to every assessee, being a company mentioned in this section [Section 115JB(5)].

(x) Non-applicability of MAT [Section 115JB(5A)].

The provisions of MAT u/s 115JB shall not apply

- to any income accruing or arising to a company from life insurance business referred to in section 115B.
- a company who has exercised the option under section 115BAA or section 115BAB.

(xi) Non-applicability of MAT in respect of certain foreign companies

Explanation 4 to section 115JB(2) with retrospective effect from 01.04.2001 provides for non-applicability of levy of MAT under section 115JB in the following cases:

	Existence of DTAA with the country of residence of the foreign company	Additional condition to be satisfied for non-applicability of MAT
(i)	The foreign company is a resident of a country or a specified territory with which India has a DTAA under section 90(1) or the Central Government has adopted any agreement between specified associations for double taxation relief under section 90A(1)	It should not have a permanent establishment in India in accordance with the provisions of such Agreement

(ii)	The foreign company is a resident of a country with which India does not have an agreement of the nature referred to in clause (i) above	It is not required to seek registration under any law for the time being in force relating to companies.

Explanation 4A to section 115JB has been inserted with retrospective effect from 01.04.2001 to clarify that MAT provisions shall not be 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 presumptive rates specified in these sections.

(xii) Concessional rate of MAT for unit located in IFSC

In case of a company, being a unit located in International Financial Services Centre and deriving its income solely in convertible foreign exchange, the minimum alternate tax shall be chargeable at the rate of 9% instead of 15%. [Section 115JB(7)]

ILLUSTRATION 1

A domestic company, ABC Ltd., furnishes the following particulars in respect of Assessment Year 2026-27 and seeks your opinion on the application of section 115JB. You are also required to compute the total income and tax payable.

(1)	*Profits as per Statement of profit and loss as per the Companies Act, 2013*			*₹ 215 lakhs*
(2)	*Statement of Profit and Loss includes:*			
	(a)	*Credits:*	*Dividend income from Indian companies*	*₹ 20 lakhs*
			Excess realized on sale of land held as investment	*₹ 30 lakhs*
	(b)	*Debits:*	*Depreciation on straight line method basis*	*₹ 100 lakhs*
			Provision for loss of subsidiary company	*₹ 60 lakhs*
(3)	*Depreciation allowable as per the Income-tax Rules, 1962*			*₹ 150 lakhs*
(4)	*Short term capital gains on sale of land mentioned above as computed under Income-tax Act, 1961*			*₹ 40 lakhs*
(5)	*Losses brought forward as per books of account and as per Income-tax Act, 1961:*			
	Business loss			*₹ 50 lakhs*
	Unabsorbed depreciation			*₹ 60 lakhs*

You will have to deal with this issue assuming that ABC Ltd. is not required to comply with the Indian Accounting Standards. Ignore the provisions of section 115BAA.

Note - *The turnover of ABC Ltd. for the P.Y. 2023-24 was ₹ 390 crore.*

SOLUTION

In the case of a company, it has been provided that where tax @15% of book profit exceeds tax on total income computed as per normal provisions, the book profit shall be deemed to be the total income for tax purposes.

It is therefore necessary to compute total income as per Income-tax Act, 1961 as well as book profits.

I. Computation of Total Income as per the normal provisions of the Income-tax Act, 1961

Particulars	₹ (in Lakhs)	
Net profit as per statement of profit and loss		215
Add: Depreciation debited to statement of profit and loss	100	
Provision for losses of subsidiary company	60	160
		375
Less: Dividend income from Indian companies	20	
Excess realized on sale of land (considered separately)	30	
Depreciation allowable as per Income-tax Rules, 1962	150	200
Business Income		175
Less: Set-off of brought forward business loss		50
		125
Capital gains (Short term capital gains)		40
Income from other sources (Dividend income chargeable to tax in the hands of shareholders)		20
		185
Less: Set-off of unabsorbed depreciation		60
Total Income as per Income-tax Act, 1961		**125**

II. Computation of book profit under section 115JB

Particulars	(₹ in Lakhs)	
Net profit as per statement of profit and loss		215
Add: Provision for loss of subsidiary		60
Depreciation as per books of account		100
		375

Less: Depreciation as per books of account	100	
Business loss which is less than unabsorbed depreciation	50	150
"Book Profit"		**225**

III. Computation of tax payable under the normal provisions of the Income-tax Act, 1961

Total income as per the Income-tax Act, 1961 is ₹ 125 lakhs,

Particulars	₹
Tax payable ₹ 125 lakhs @25% since the turnover of the company for the previous year 2023-24 ≤ ₹ 400 crore.	31,25,000
Add: Surcharge @ 7%	2,18,750
	33,43,750
Add: Health and education cess @4%	1,33,750
Total Tax payable	**34,77,500**

IV. Computation of Minimum Alternate Tax

Particulars	₹
Tax @ 15% of book profit of ₹ 225 lakhs	33,75,000
Add: Surcharge @ 7%	2,36,250
	36,11,250
Add: Health and education cess@4%	1,44,450
Minimum Alternate Tax payable	**37,55,700**

Since 15% of book profit exceeds the tax payable as per normal provisions of the Income-tax Act, 1961, the book profit of ₹ 225 lakhs would be deemed to be the total income and the tax payable on such total income shall be 15% thereof i.e., ₹ 33,75,000 *plus* surcharge @7% being ₹ 2,36,250 *plus* health and education cess @4% (of tax and surcharge) being ₹ 1,44,450. Total tax liability would be ₹ 37,55,700.

ILLUSTRATION 2

Maitri Jeans (P) Ltd. is in the business of manufacturing jeans. For the assessment year 2026-27, it paid tax @15% on its book profit computed under section 115JB. The Assessing Officer though satisfied that it is liable to pay book profit tax under section 115JB, wants to charge interest under sections 234B and 234C as no advance tax was paid during the financial year 2025-26. The company seeks your opinion on the proposed levy of interest.

SOLUTION

The issue under consideration is whether interest under sections 234B and 234C can be levied where a company is assessed on the basis of its book profit under section 115JB.

The Supreme Court, in *Joint CIT v. Rolta India Ltd. (2011) 330 ITR 470*, observed that there is a specific provision in section 115JB(5) providing that all other provisions of the Income-tax Act, 1961 shall apply to every assessee, being a company, mentioned in that section. Section 115JB is a self-contained code pertaining to MAT, and by virtue of sub-section (5) thereof, the liability for payment of advance tax would be attracted.

According to section 207, tax shall be payable in advance during any financial year, in accordance with the provisions of sections 208 to 219 (both inclusive), in respect of the total income of the assessee which would be chargeable to tax for the assessment year immediately following that financial year.

Under section 115JB(1), where the tax payable on total income is less than 15% of "book profit" of a company, the "book profit" would be deemed to be the total income and tax would be payable at the rate of 15%.

Since in such cases, the book profit is deemed to be the total income, therefore, as per the provisions of section 207, tax shall be payable in advance in respect of such book profit (which is deemed to be the total income) also.

Therefore, if a company defaults in payment of advance tax in respect of tax payable under section 115JB, it would be liable to pay interest under sections 234B and 234C.

Therefore, even though Maitri Jeans (P) Ltd. is assessed on the basis of its book profit under section 115JB for A.Y.2026-27, it is liable to pay advance tax. Since Maitri Jeans (P) Ltd. has not paid any advance tax during the financial year 2025-26, the levy of interest under section 234B and 234C is valid.

ILLUSTRATION 3

Sona Ltd., a resident company, earned a profit of ₹ 15 lakhs after debit/credit of the following items to its Statement of Profit and Loss for the year ended on 31/03/2026.

(i) Items debited to Statement of Profit and Loss:

No.	*Particulars*	*₹*
1.	*Provision for the loss of subsidiary*	*70,000*
2.	*Provision for doubtful debts*	*75,000*

3.	*Provision for income-tax*	*1,05,000*
4.	*Provision for gratuity based on actuarial valuation*	*2,00,000*
5.	*Depreciation*	*3,60,000*
6.	*Interest to financial institution (unpaid before filing of return)*	*1,00,000*
7.	*Penalty for infraction of law*	*50,000*

(ii) *Items credited to Statement of Profit and Loss:*

No.	Particulars	₹
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 on sale of building*	*3,00,000*

Other Information:

(i) *Depreciation includes ₹ 1,50,000 on account of revaluation of fixed assets.*

(ii) *Depreciation as per Income-tax Rules is ₹ 2,80,000.*

(iii) *Brought forward loss as per books of account of the company is of ₹ 10 lakhs which includes unabsorbed depreciation of ₹ 4 lakhs.*

(iv) *The AOPs, of which the company is a member, has paid tax at maximum marginal rate.*

(v) *Provision for income-tax includes ₹ 45,000 of interest payable on income-tax.*

Compute minimum alternate tax under section 115JB of the Income-tax Act, 1961, for A.Y. 2026-27, assuming that Sona Ltd. is not required to comply with the Indian Accounting Standards. Ignore the provisions of section 115BAA.

SOLUTION

Computation of "Book Profit" for levy of MAT under section 115JB for A.Y. 2026-27

Particulars	₹	₹
Net Profit as per Statement of Profit and Loss		15,00,000
Add: Net profit to be increased by the following amounts as per *Explanation 1* to section 115JB		
- Provision for the loss of subsidiary	70,000	
- Provision for doubtful debts, being the amount set aside as provision for diminution in the value of any asset	75,000	

- Provision for income-tax [As per *Explanation 2* to section 115JB, income-tax shall include, *inter alia*, any interest charged under the Act. Therefore, whole of the amount of provision for income-tax including ₹ 45,000 towards interest payable has to be added]	1,05,000	
- Depreciation	3,60,000	6,10,000
		21,10,000
Less: Net profit to be decreased by the following amounts as per *Explanation 1* to section 115JB:		
- Share in income of an AOP as a member [In a case, where AOP has paid tax on its total income at maximum marginal rate, no income-tax is payable by the company, being a member of AOP, in accordance with the provisions of section 86. Therefore, share in income of an AOP on which no income-tax is payable in accordance with the provisions of section 86, would be reduced while computing book profit, since the same has been credited to Statement of Profit and Loss]	1,00,000	
- Income from units in UTI [Income from units in UTI is taxable in the hands of the unitholders thus, the same would not be reduced while computing book profits even though it is credited in the Statement of Profit and Loss]	-	
- Depreciation other than depreciation on revaluation of assets (₹ 3,60,000 – ₹ 1,50,000)	2,10,000	
- Unabsorbed depreciation or brought forward business loss, whichever is less, as per the books of account. [Lower of unabsorbed depreciation ₹ 4,00,000 and brought forward business loss ₹ 6,00,000 as per books of accounts has to be reduced while computing the book profit]	4,00,000	7,10,000
Book Profit		**14,00,000**

Computation of MAT liability under section 115JB

Particulars	₹
15% of book profit	2,10,000
Add: Health and education cess@4%	8,400
Minimum Alternate Tax liability	**2,18,400**

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 for computing book profit:

- Interest to financial institution (unpaid before filing of return) and
- Penalty for infraction of law

(2) Provision for gratuity based on actuarial valuation is an ascertained liability *[CIT v. Echjay Forgings (P) Ltd. (2001) 251 ITR 15 (Bom.)]*. Hence, the same should not be added back to compute book profit.

(3) As per proviso to section 115JB(6), the profits from unit established in special economic zone cannot be excluded while computing the book profit, and hence, such income would be liable for MAT.

(xiii) Set-off of credit of tax paid under section 115JB [Section 115JAA]

(1) This section provides that where tax is paid in any assessment year in relation to the deemed income under section 115JB(1), the excess of tax so paid over and above the tax payable under the other provisions of the Income-tax Act, 1961, will be allowed as tax credit in the subsequent years. However, no interest would be payable on the tax credit allowed.

(2) The tax credit is, therefore, the difference between the tax paid under section 115JB(1) and the tax payable on the total income computed in accordance with the other provisions of the Act.

(3) This tax credit is allowed to be carried forward for **15 assessment years** succeeding the assessment year in which the credit became allowable.

(4) Such credit is allowed to be set off against the tax payable on the total income in an assessment year in which the tax is computed in accordance with the provisions of the Act, other than 115JB, to the extent of excess of such tax payable over the tax payable on book profits in that year.

Example:

P.Y.	MAT as per section 115JB	Tax as per regular provisions	MAT Credit Adjustment	Actual Tax Paid	MAT Credit Balance
2023-24	4,50,000	3,95,000	-	4,50,000	55,000
2024-25	4,70,000	4,10,000	-	4,70,000	1,15,000 [55,000 + 60,000]
2025-26	3,80,000	4,00,000	20,000	3,80,000	95,000

(5) Where as a result of order passed, the amount of tax payable is reduced or increased, the amount of tax credit allowed shall also be reduced or increased accordingly.

(6) In case of conversion of a private company or unlisted public company into an LLP, the tax credit under section 115JAA for MAT paid by the company under section 115JB would not be allowed to the successor LLP.

(7) 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 the provisions of section 115JB(1) exceeds the amount of such tax credit admissible against the tax payable by the assessee on its income in accordance with the other provisions of this Act, then, while computing the amount of credit under this sub-section, such excess amount shall be ignored.

In other words, the amount of tax credit in respect of MAT shall not be allowed to be carried forward to subsequent year to the extent such credit relates to the difference between the amount of foreign tax credit (FTC) allowed against MAT and FTC allowable against the tax computed under regular provisions of Act other than the provisions relating to MAT.

Example:

Particulars	Tax as per regular provisions	MAT as per section 115JB
Tax amount	1,50,000	1,75,000
FTC	1,60,000	1,60,000
Deduction in respect of FTC, being lower of tax payable in India and FTC	1,50,000	1,60,000
Excess FTC allowed against MAT under section 115JB		10,000
MAT credit		25,000
MAT Credit as reduced by excess FTC allowable against MAT liability (₹ 25,000 – ₹ 10,000)		15,000

(8) A company opting for section 115BAA cannot set-off MAT credit available to it under section 115JAA from the year in which it exercises such option.

(5) Special provisions relating to income of shipping companies

To make the Indian shipping industry more competitive, a tonnage tax scheme for taxation of shipping profits was introduced. To further promote inland water transportation in the country and to encourage investments in this sector, the scope of this scheme has been extended to include Inland Vessels registered under Inland Vessels Act, 2021.

Chapter XII-G, containing sections 115V to 115VZC, provides for special provisions relating to taxation of the income of shipping companies. With the introduction of tonnage tax scheme, the companies have to exercise the option to be assessed under this scheme or under the normal provisions of the Income-tax Act. The salient features of the scheme are as follows:

- A company owning at least one qualifying ship may join.
- A qualifying ship is one with a minimum tonnage of 15 tons and having a valid certificate.
- If a company is incorporated after the initial period i.e., 31.12.2004 or a company which is incorporated before the initial period but becomes a qualifying company for the first time after the initial period, this application is required to be made within three months of the date of incorporation or the date on which it becomes a qualifying company, as the case may be.

(I) Computation of Tonnage Income from Business of Operating Qualifying Ships

Computation of profits and gains from the business of operating qualifying ships [Section 115VA]

(1) A company has the option to compute the income from the business of operating qualifying ships in accordance with the provisions of this Chapter.

(2) Such income is deemed to be the income chargeable to tax under the head "Profits and gains of business or profession" in respect of such business.

Operating ships [Section 115VB]

(1) A company shall be regarded as operating a ship ***or inland vessel, as the case may be***, if it operates any ship ***or inland vessel, as the case may be***, whether owned or chartered by it.

(2) Even if only a part of the ship ***or inland vessel, as the case may be***, has been chartered in by it in an arrangement such as slot charter, space charter or joint charter, the company would be regarded as operating a ship.

(3) However, a company will not be regarded as the operator of a ship ***or inland vessel, as the case may be***, which has been chartered out on bareboat charter-cum-demise terms or on bareboat charter terms for a period exceeding three years.

(4) "Bareboat charter" means hiring of a ship ***or inland vessel, as the case may be***, for a stipulated period on terms which give the charterer possession and control of the ship ***or inland vessel, as the case may be***, including the right to appoint the master and crew.

(5) "Bareboat charter-cum-demise" means a bareboat charter where the ownership of the ship ***or inland vessel, as the case may be,*** is intended to be transferred after a specified period to the company to whom it has been chartered.

Meaning of "Qualifying company" [Section 115VC]

(1) A company will be a qualifying company if -

- (a) it is an Indian company;
- (b) the place of effective management of the company is in India;
- (c) it owns at least one qualifying ship; and
- (d) the main object of the company is to carry on the business of operating ships.

(2) The expression "place of effective management of the company" has been defined in the *Explanation* to the section to mean –

- (a) the place where the board of directors of the company or its executive directors make their decisions; or
- (b) in a case where the board of directors routinely approve the commercial and strategic decisions made by the executive directors or officers of the company, the place where such executive directors or officers of the company perform their functions.

Meaning of "Qualifying ship" [Section 115VD]

(1) A ship ***or inland vessel, as the case may be***, is a qualifying ship if

- (i) it is a seagoing ship or vessel ***or inland vessel, as the case may be,*** of 15 net tonnage or more;
- (ii) ship is registered –
  - (a) under the Merchant Shipping Act, 1958; or
  - (b) outside India in respect of which a license has been issued by the Director-General of Shipping under section 406 or 407 of the Merchant Shipping Act, 1958; or

  ***inland vessel* is registered –**

  - **(c)** ***under the Inland Vessels Act, 2021.***
- (iii) there is a valid certificate in force indicating the net tonnage of such a ship ***or inland vessel, as the case may be;***

(2) However, the following ships ***or inland vessel*** are not "qualifying ships" –

- (i) a seagoing ship or vessel ***or inland vessel, as the case may be***, if the main purpose for which it is used is for the provision of goods or services of a kind normally provided on land ("seagoing ship" means a ship which is certified as seagoing by the competent authority of any country);

(ii) fishing vessels;

(iii) factory ships (which includes a vessel providing processing services in respect of processing of the fishing produce);

(iv) pleasure craft (i.e. a ship ***or inland vessel***, whose primary use is for the purposes of sport or recreation);

(v) harbour and river ferries;

(vi) offshore installations;

(vii) a qualifying ship which is used as a fishing vessel for a period of more than thirty days during a previous year.

Manner of computation of income under tonnage tax scheme [Section 115VE]

(1) A tonnage tax company engaged in the business of operating qualifying ships should compute the profits from such business under the tonnage tax scheme;

(2) "Tonnage tax company" means a qualifying company in relation to which tonnage tax option is in force;

(3) "Tonnage tax scheme" means a scheme for computation of profits and gains of business of operating qualifying ships under the provisions of this Chapter.

(4) The business of operating qualifying ships giving rise to "relevant shipping income" (i.e. income referred to in section 115V-I(1)) has to be considered as a separate business, distinct from all other activities or business carried on by the company.

(5) Such profits should be computed separately from the profits and gains from any other business.

(6) The tonnage tax scheme will apply only if an option to that effect is made (in accordance with the provisions of section 115VP).

(7) The profits and gains from the business of operating qualifying ships of a company engaged in such business and –

(a) not covered under the tonnage tax scheme or,

(b) which has not made an option to that effect,

have to be computed in accordance with the other provisions of this Act.

Tonnage income [Section 115VF]

(1) "Tonnage income" means the income of a tonnage tax company computed in accordance with the provisions of this Chapter. The tonnage income has to be computed in accordance with the provisions of section 115VG given below.

(2) The income so computed is deemed to be the profits chargeable under the head "Profits and gains of business or profession".

(3) Where income is so computed under section 115VG, the relevant shipping income (referred to in section 115V-I(1)) will not be chargeable to tax.

Computation of tonnage income [Section 115VG]

(1) The tonnage income for a previous year is the aggregate of the tonnage income of each qualifying ship.

(2) The tonnage income of a qualifying ship is to be calculated on the basis of the daily tonnage income of such ship multiplied by the number of days in the previous year.

(3) In case the ship is operated by the company as a qualifying ship for only part of the previous year, the tonnage income of the ship will be calculated on the basis of daily tonnage of such ship multiplied by the number of days in part of the previous year.

(4) The daily tonnage income of a qualifying ship has to be computed as under –

Qualifying ship having net tonnage	Amount of daily tonnage income
Up to 1000	₹ 70 for each 100 tons
Exceeding 1,000 but not more than 10,000	₹ 700 plus ₹ 53 for each 100 tons exceeding 1,000 tons
Exceeding 10,000 but not more than 25,000	₹ 5,470 plus ₹ 42 for each 100 tons exceeding 10,000 tons
Exceeding 25,000	₹ 11,770 plus ₹ 29 for each 100 tons exceeding 25,000 tons

(5) "Tonnage" means the tonnage of a ship ***or inland vessel, as the case may be***, indicated in the "valid certificate" (i.e., referred to in section 115VX) and includes deemed tonnage computed in the prescribed manner.

(6) "Deemed tonnage" means the tonnage in respect of an arrangement of purchase of slots, slot charter and an arrangement of sharing of break-bulk vessel.

(7) The tonnage is to be rounded off to the nearest multiple of hundred tons. For this if the last figure that amount of tonnage is fifty or more, the tonnage shall be increased to the next

higher tonnage which is a multiple of 100, otherwise, shall be reduced to the next lower tonnage which is a multiple of 100.

(8) No deduction or set-off is allowed in computing the tonnage income under this Chapter.

ILLUSTRATION 4

Calculate tonnage income with respect to each of the following qualifying ships:

Qualifying Ships	Q1	Q2	Q3	Q4
Net Tonnage	1,020	8,563	22,368	37,525
Days for which ship operated during the P.Y.2025-26	120	70	250	100

SOLUTION

Qualifying Ships	Q1	Q2	Q3	Q4
Net Tonnage (rounded off)	1,000	8,600	22,400	37,500
Daily Tonnage (₹)	700	4,728	10,678	15,395
Days for which ship operated during the P.Y.2025-26	120	70	250	100
Tonnage Income (₹)	84,000	3,30,960	26,69,500	15,39,500

Calculation of tonnage income in case of joint operation [Section 115VH]

(1) Where a qualifying ship is operated by two or more companies –

(a) by way of joint interest in the ship or by way of an agreement for the use of the ship and

(b) their respective shares are definite and ascertainable,

the tonnage income of each such company shall be an amount equal to a share of income proportionate to its share of interest.

(2) Where two or more companies are operators of a qualifying ship, the tonnage income of each company shall be computed as if each had been the only operator, if the conditions specified in (a) and (b) of (1) above are not satisfied.

Meaning of "Relevant shipping income" [Section 115V-I]

(1) The "relevant shipping income" of a tonnage tax company means its profits from core activities and its profits from incidental activities

(2) Where the aggregate of income from incidental activities exceeds ¼th % of the turnover from core activities, such excess will not form part of relevant shipping income for the purposes of this Chapter and shall be taxable under the other provisions of this Act.

(3) The core activities of a tonnage tax company are –

(i) its activities from operating qualifying ships; and

(ii) Other ship-related activities ***or inland vessel related activities, as the case may be***, being,

(a) shipping contracts in respect of –

(1) earnings from pooling arrangements i.e.

(i) agreement between two or more persons for providing services through a pool or

(ii) operating one or more ships ***or inland vessel, as the case may be,*** and sharing earnings or operating profits on the basis of mutually agreed terms;

(2) contracts of affreightment i.e. a service contract under which a tonnage tax company agrees to transport a specified quantity of specified products at a specified rate, between designated loading and discharging ports over a specified period.

(b) Specific shipping trades, being, -

(1) on-board or onshore activities of passenger ships comprising of fares and food and beverages consumed on board;

(2) slot charters, space charters, joint charters, feeder services, container box leasing of container shipping.

(4) The incidental activities of the tonnage tax company are the activities which are incidental to the core activities and which may be prescribed for the purpose.

(5) The Central Government can, by notification, exclude any activity under "other ship-related activities ***or inland vessel related activities***" mentioned in (3) above or prescribe the limit up to which such activities can be included in the core activities.

(6) Every notification issued under this Chapter has to be laid before each House of Parliament to make the same effective.

(7) If both Houses agree in making any modification therein, the notification will have effect in such modified form.

(8) Similarly, if both Houses agree that the notification should not be issued, then such notification will be of no effect.

(9) However, such modification or annulment will not affect anything previously done under that notification.

(10) Where a tonnage tax company operates any ship ***or inland vessel, as the case may be***, which is not a qualifying ship, then the income attributable to operation of the non-qualifying ship should be computed in accordance with the other provisions of this Act.

(11) In the following cases, the relevant shipping income is to be computed as if the transfer had been at market value of the goods and services as on the date of transfer–

   (i) Where any goods or services held for the purposes of tonnage tax business are transferred to any other business carried on by a tonnage tax company, or

   (ii) where any goods or services held for the purposes of any other business carried on by such tonnage tax company are transferred to the tonnage tax business, and

   (iii) In both the above cases, the consideration, if any, for such transfer as recorded in the accounts of the tonnage tax business does not correspond to the market value of such goods or services as on the date of the transfer,

(12) Market value in relation to any goods and services means the price that such goods or services would ordinarily fetch on sale in the open market.

(13) Where the computation of the relevant shipping income in the manner specified above presents exceptional difficulties, the Assessing Officer may compute such income on such reasonable basis as he may deem fit.

(14) If the Assessing Officer is of the opinion that owing to the close connection between the tonnage tax company and such other person or for any other reason, the affairs of the business transacted between the tonnage tax company and any other person are arranged in such a manner that the company gets more than the ordinary profits which might be expected to arise in the tonnage tax business, then he may take into account the amount of income which may be reasonably deemed to have been derived therefrom for computing the relevant shipping income.

(15) In case the relevant shipping income of a tonnage tax company is a loss, then, such loss is to be ignored for the purposes of computing tonnage income.

Treatment of common costs [Section 115VJ]

(1) Where a tonnage tax company also carries on any business or activity other than the tonnage tax business, the common costs attributable to the tonnage tax business should be determined on a reasonable basis.

(2) Where any asset, other than qualifying ship, is not exclusively used for the tonnage tax business by the tonnage tax company, depreciation on such asset has to be allocated between its tonnage tax business and other business.

(3) Such allocation of depreciation has to be done on a fair proportion to be determined by the Assessing Officer, having regard to the use of such asset for the purpose of the tonnage tax business and for the other business.

Depreciation [Section 115VK]

(1) The depreciation for the first previous year of the tonnage tax scheme has to be computed on the written down value of the qualifying ships.

(2) The written down value of the block of assets, being ships ***or inland vessel, as the case may be,*** as on the first day of the previous year, has to be divided in the ratio of the book written down value of the qualifying ships (qualifying assets) and the book written down value of the non-qualifying ships (other assets).

(3) The block of qualifying assets would constitute a separate block of assets.

(4) The manner of computing the book written down value of the block of qualifying assets and the block of other assets is as follows –

  (a) the book written down value of each qualifying asset and each other asset as on the first day of the previous year is to be determined by taking the book written down value of each asset appearing in the books of account as on the last day of the preceding previous year;

  (b) Any change in the value of assets consequent to their revaluation after 10.9.04 is to be ignored;

  (c) The book written down value of all the qualifying assets and other assets are to be aggregated;

  (d) The ratio of the aggregate book written down value of the qualifying assets to the aggregate book written down value of the other assets has to be determined.

(5) In case an asset forming part of the block of qualifying assets begins to be used for purposes other than the tonnage tax business, an appropriate portion of the written down value allocable to such asset i.e., the amount which bears the same proportion to the written down

value of the block of qualifying assets as on the first day of the previous year as the book written value of the asset beginning to be used for purpose other than tonnage tax business bears to the book written down value of all the assets forming the block of qualifying assets, has to be reduced from the written down value of that block and added to the block of other assets.

(6) In case an asset forming part of the block of other assets begins to be used for tonnage tax business, an appropriate portion of the written down value allocable to such asset i.e., the amount which bears the same proportion to the written down value of the block of other assets as on the first day of the previous year as the book written value of the asset beginning to be used for tonnage tax business bears to the total book written down value of all the assets forming the block of other assets, has to be reduced from the written down value of the block of other assets and has to be added to the block of qualifying asset.

(7) Depreciation computed for the previous year on such asset mentioned in (6) shall be allocated in the ratio of number of days for which the asset was used for the tonnage tax business and for purposes other than tonnage tax business.

(8) Depreciation on the block of qualifying assets and block of other assets so created shall be allowed as if the written down value as on the first previous year has been brought forward from the preceding previous year.

(9) The expression "book written down value" means the written down value as appearing in the books of account.

Deemed deduction and set-off and carry forward of losses etc. [Section 115VL]

(1) Any loss/allowance or deduction under sections 30 to 43B relating to or allowable for any of the relevant previous years, would be deemed to have been given full effect to in that previous year itself;

(2) No set-off or carry forward of losses referred to in –

(i) sections 70(1) and 70(3); or

(ii) sections 71(1) and 71(2); or

(iii) section 72(1) or

(iv) section 72A(1),

relating to the business of operating qualifying ships of the company is permissible where such loss relates to any of the previous years when the company is under the tonnage tax scheme;

(3) No deduction under Chapter VI-A is allowable in relation to the profits and gains from the business of operating qualifying ships;

(4) In computing the depreciation allowance under section 32, the written down value of any asset used for the purposes of the tonnage tax business has to be computed as if the company has claimed and has been actually allowed the deduction in respect of depreciation for the relevant previous year.

Set-off and carry forward of losses of tonnage tax business [Section 115VM]

(1) Any losses attributable to its tonnage tax business that have accrued to a company before its entry in tonnage tax scheme can be set off only against the relevant shipping income when the company is under the tonnage tax scheme.

(2) Such losses will not be available for set off against any income other than relevant shipping income in any previous year beginning on or after the date when the company exercises its option under section 115VP.

(3) Any apportionment necessary to determine such losses should be made on a reasonable basis.

Capital gains from transfer of tonnage tax assets [Section 115VN]

(1) Profits or gains arising from the transfer of a capital asset being an asset forming part of the block of qualifying assets is chargeable to income-tax in accordance with the provisions of section 45, read with section 50.

(2) The capital gains so arising has to be computed in accordance with the provisions of sections 45 to 51.

Book profit or loss to be excluded for the purpose of section 115JB [Section 115VO]

This section seeks to exclude the book profits or loss derived from the activities of a tonnage tax company (referred to in section 115V-I(1)) for the purposes of section 115JB.

(II) Procedure for Option of Tonnage Tax Scheme

Method and time of opting for tonnage tax scheme [Section 115VP]

(1) A qualifying company may opt for the tonnage tax scheme by making an application to the Joint-Commissioner having jurisdiction over the company in the prescribed form and manner.

(2) An existing qualifying company should make an application at any time after 30th September 2004 but before 1st January 2005, which is the initial period.

(3) In case of a company incorporated after the initial period or a company incorporated before the initial period but which becomes a qualifying company for the first time after the initial period, an application can be made within three months of the date of its incorporation or the date on which it became a qualifying company, as the case may be.

(4) The Joint Commissioner, on receipt of an application for option for tonnage tax scheme, may call for such information or documents from the company as he thinks necessary in order to satisfy himself about the eligibility of the company.

(5) After satisfying himself about the eligibility of the company to make such option for tonnage tax scheme, he can either pass an order in writing approving the option for tonnage tax scheme or, if he is not so satisfied, pass an order in writing refusing to approve the option for tonnage tax scheme.

(6) A copy of such order should be sent to the applicant.

(7) An order refusing to approve the option for tonnage tax scheme can be passed only after giving the applicant a reasonable opportunity of being heard.

(8) Every order granting or refusing the approval of the option for tonnage tax scheme should be passed before the expiry of one month from the end of the month in which the application was received. ***However, for an application received on or after 1.4.2025, order of granting or refusing the approval of the option for tonnage tax scheme should be passed before the expiry of three months from the end of the quarter in which the application was received.***

(9) Where an order granting approval for tonnage tax scheme is passed, the provisions of this Chapter will apply from the assessment year relevant to the previous year in which the option for tonnage tax scheme is exercised.

Period for which the tonnage tax option will remain in force [Section 115VQ]

(1) An option for tonnage tax scheme (after it has been approved under section 115VP(3)) would remain in force for a period of ten years from the date on which such option has been exercised.

(2) For this purpose, the option would be taken into account from the assessment year relevant to the previous year in which such option is exercised.

(3) An option for tonnage tax scheme would cease to have effect from the assessment year relevant to the previous year in which –

    (i) the qualifying company ceases to be so or

(ii) a default is made in complying with the provisions contained in section 115VT or section 115VU or section 115VV.

(4) The tonnage tax option will also cease to have effect in case –

(i) a company is excluded from the tonnage tax scheme under section 115VZC or

(ii) the qualifying company furnishes to the Assessing Officer, a declaration in writing to the effect that the provisions of this Chapter may not be made applicable to it.

(5) In such a case, the profits of the company from the business of operating qualifying ships shall be computed in accordance with the other provisions of the Act.

Renewal of tonnage tax scheme [Section 115VR]

(1) An option for tonnage tax scheme approved under section 115VP may be renewed within one year from the end of the previous year in which the option ceases to have effect.

(2) The provisions of sections 115VP and 115VQ discussed above would apply in relation to a renewal of the option for tonnage tax scheme in the same manner as they apply in relation to the approval of option for tonnage tax scheme.

Bar from opting for tonnage tax scheme in certain cases [Section 115VS]

(1) A qualifying company is not eligible to opt for the tonnage tax scheme if –

(i) the company, on its own, opts out of the tonnage tax scheme or

(ii) it makes a default in complying with the provisions of section 115VT or section 115VU or section 115VV or

(iii) its option has been excluded from tonnage tax scheme in pursuance of an order made under section 115VZC(1).

(2) In such cases, the qualifying company will not be eligible to opt for tonnage tax scheme for a period of ten years from the date of such opting out or default or order, as the case may be.

(III) Conditions for Applicability of Tonnage Tax Scheme

Transfer of profits to Tonnage Tax Reserve Account [Section 115VT]

(1) A tonnage tax company is required to credit to a reserve account (called Tonnage Tax Reserve Account) an amount not less than 20% of the book profits derived from its core and incidental activities (referred to in section 115V-I(1)) in each previous year to be utilised in the manner laid down below –

(i) The amount credited should be utilized for acquiring a new ship ***or new inland vessel, as the case may be***, before the expiry of 8 years for the purposes of the business of the company; and

(ii) Until the acquisition of a new ship ***or new inland vessel, as the case may be***, the amount can be utilized for the purposes of the business of operating qualifying ships other than for distribution by way of dividends or profits or for remittance outside India as profits or for the creation of any asset outside India. [Sub-section (3)]

(2) A tonnage tax company may transfer a sum in excess of twenty per cent of the book profits. Such excess sum transferred should also be utilised in above manner.

(3) "Book profit" will have the same meaning as in the *Explanation* to section 115JB(2) so far as it relates to income derived from the core and incidental activities.

(4) Where the company has book profit from the business of operating qualifying ships and book loss from any other source, and consequently, the company is not in a position to create the full or any part of the reserves as required, then –

(a) the company should create the reserves to the extent possible in that previous year.

(b) The shortfall, if any, will be added to the amount of the reserves required to be created for the following previous year.

(c) Such shortfall will be deemed to be part of the reserve requirement of that following previous year.

(5) **Consequences of mis-utilisation / non-utilisation [Sub-section (4)]**

(i) Where any amount credited to the Tonnage Tax Reserve Account has –

(a) been utilized for any purpose other than that referred to in (1) above; or

(b) not been utilized for the purpose of acquiring a new ship for the purpose of the business of the company within 8 years; or

(c) has been utilized for acquiring a new ship ***or new inland vessel, as the case may be***, within 8 years but such ship ***or inland vessel*** is sold or transferred, otherwise than in any scheme of demerger, within 3 years from the end of the previous year in which it was acquired

then, an amount which bears the same proportion to the total relevant shipping income of the year in which such reserve was created, as the amount out of such reserve so utilized or not utilized bears to the total reserve created during that year shall be taxable under the other provisions of the Act i.e.

Taxable amount =

Relevant shipping income $\times \dfrac{\text{Extent of reserves unutilized or misutilised}}{\text{Total reserve created during the year}}$

(ii) Such amount as calculated above would be taxable -

(a) in case (a) of (i) above, in the year in which the amount was so utilized; or

(b) in case (b) of (i) above, in the year immediately following the period of 8 years;

(c) in case (c) of (i) above, in the year in which the sale or transfer took place.

(iii) However, the income so taxable under the other provisions of the Act will be reduced by the proportionate tonnage income charged to tax in the year of creation of such reserves.

(6) **Shortfall in credit to Tonnage Tax Reserve Account [Sub-section (5)]**

If there is any shortfall in the amount credited to the Tonnage Tax Reserve Account, then the amount which bears the same proportion to the total relevant shipping income as the shortfall in credit to the reserves bears to the minimum reserve required to be credited, will be taxable under the other provisions of the Act i.e.,

Taxable amount = Relevant shipping income $\times \dfrac{\text{Shortfall in credit to reserves}}{\text{Minimum reserve to be credited}}$

(7) **Consequences of failure to create reserve for two consecutive previous years [Sub-section (6)]** -If the reserve required to be created is not created for any two consecutive previous years, the option of the company for tonnage tax scheme will cease to have effect from the beginning of the previous year following the second consecutive previous year in which the failure to create the reserve had occurred.

(8) ***Meaning of "new ship or inland vessel":*** *A new ship or inland vessel, as the case may be, includes a 'qualifying ship', which before the date of its acquisition by the qualifying company was used by any other person. However, it should not have been owned by any person resident in India before the date of such acquisition.*

ILLUSTRATION 5

Dolphy Ltd., a tonnage tax company provides following information for the P.Y. 2025-26:

(i) Relevant Shipping Income - ₹ 350 lakhs

(ii) Tonnage Income - ₹ 180 lakhs

(iii) Book profits derived from core and incidental activities - ₹ 400 lakhs

Provide answers to following questions, considering each of the questions given below independently:

(a) Calculate the minimum reserve requirement of the company as per section 115VT.

(b) Calculate the taxable amount under the other provisions of the Act, if Dolphy Ltd. transferred only ₹ 66 lakhs to tonnage tax reserve account during the P.Y. 2026-27.

(c) Calculate the taxable amount under the other provisions of the Act, if Dolphy Ltd. mis-utilised amount of ₹ 12 lakhs during P.Y. 2026-27 out of ₹ 92 lakhs transferred to tonnage tax reserve account during P.Y. 2025-26.

SOLUTION

(a) The minimum reserve requirement of the company as per section 115VT = 20% of the book profits derived from core and incidental activities = ₹ 400 lakhs × 20% = **₹ 80 lakhs**

(b) Taxable amount under the other provisions of the Act = Relevant shipping income × Shortfall in the credit to the reserves/ Minimum reserve requirement = ₹ 350 lakhs × [(₹ 80 lakhs – 66 lakhs) / ₹ 80 lakhs)] = ₹ 350 lakhs × ₹ 14 lakhs / ₹ 80 lakhs = **₹ 61.25 lakhs**

(c) Taxable amount under the other provisions of the Act for P.Y. 2026-27 = Relevant shipping income during P.Y. 2025-26 × Extent of reserves misutilised/Total reserve created during P.Y. 2025-26 = ₹ 350 lakhs × ₹ 12 lakhs / ₹ 92 lakhs = **₹ 45.65 lakhs**

Minimum training requirement for a tonnage tax company [Section 115VU]

(1) A tonnage tax company, after its option has been approved under section 115VP(3) is required to comply with the minimum training requirement in respect of trainee officers in accordance with the guidelines framed by the Director-General of Shipping and notified in the Official Gazette by the Central Government. [Sub-section (1)]

(2) A copy of the certificate issued by the Director-General of Shipping to the effect that such company has complied with the minimum training requirement in accordance with the guidelines referred to in sub-section (1) for the previous year is required to be furnished along with the return of income.

(3) If the minimum training requirement is not complied with for any five consecutive previous years, the option of the company for tonnage tax scheme shall cease to have effect from the start of the previous year following the fifth consecutive year in which the failure to comply with the minimum training requirement occurred.

Limit for charter in of tonnage [Section 115VV]

(1) Every company which has opted for tonnage tax scheme should charter in not more than 49% of the net tonnage of the qualifying ships operated by it during any previous year. The term "chartered in" does not include a ship ***or inland vessel, as the case may be***, chartered in by the company on bareboat charter-cum-demise terms.

(2) Such proportion of net tonnage in respect of a previous year is to be calculated based on the average of net tonnage during that previous year.

(3) The average of net tonnage is to be computed in such manner as may be prescribed in consultation with the Director-General of Shipping.

(4) Where the net tonnage of ships ***or inland vessel, as the case may be***, chartered in exceeds the limit of 49% during any previous year, the total income of such company in relation to that previous year is to be computed as if the option for tonnage tax scheme does not have effect for that previous year.

(5) Where the said limit of 49% is exceeded in any two consecutive previous years, the option for tonnage tax scheme shall cease to have effect from the beginning of the previous year following the second consecutive previous year in which the limit had exceeded.

Maintenance and audit of accounts [Section 115VW]

An option for tonnage tax scheme by a tonnage tax company will not have effect in relation to a previous year unless such company –

(i) maintains separate books of account in respect of the business of operating qualifying ships and

(ii) furnishes, the report of an accountant, in the prescribed form duly signed and verified by such accountant on or before the specified date referred to in section 44AB i.e., one month prior to the due date for filing return of income.

Determination of tonnage [Section 115VX]

(1) The tonnage of the ship ***or inland vessel, as the case may be***, shall be determined in accordance with the valid certificate indicating its net tonnage.

(2) "Valid certificate" means –

  (i) in case of ships registered in India—

    (a) having a length of less than twenty-four meters, a certificate issued under the Merchant Shipping (Tonnage Measurement of Ship) Rules, 1987 made under the Merchant Shipping Act, 1958;

(b) having a length of twenty-four meters or more, an international tonnage certificate issued under the provisions of the Convention on Tonnage Measurement of Ships, 1969 as specified in the Merchant Shipping (Tonnage Measurement of Ship) Rules, 1987 made under the Merchant Shipping Act, 1958;

(ii) in case of ships registered outside India,

(a) a license issued by the Director-General of Shipping under section 406 or section 407 of the Merchant Shipping Act, 1958 specifying the net tonnage on the basis of Tonnage Certificate issued by the Flag State Administration where the ship is registered or

(b) any other evidence acceptable to the Director-General of Shipping produced by the ship owner while seeking permission for chartering in the ship.

(iii) in case of inland vessel registered in India, a certificate issued under the Inland Vessels Act, 2021.

(IV) Amalgamation and Demerger of Shipping Companies

Amalgamation [Section 115VY]

(1) In case of amalgamation, the provisions relating to the tonnage tax scheme would apply to the amalgamated company if it is a qualifying company.

(2) However, where the amalgamated company is not a tonnage tax company, it should exercise an option for tonnage tax scheme under section 115VP(1) within three months from the date of the approval of the scheme of amalgamation.

(3) Where the amalgamating companies are tonnage tax companies, the provisions of this Chapter would apply to the amalgamated company for such period as the option for tonnage tax scheme which has the longest unexpired period continues to be in force.

> **Example:** If two tonnage tax companies X Ltd. and Y Ltd. are amalgamated to form a new company Z Ltd., and the option for tonnage tax scheme of X Ltd. has an unexpired period of 8 years and Y Ltd. has an unexpired period of 6 years, then the provisions of this Chapter would apply to the new company Z Ltd. for a period of 8 years.

(4) Where one of the amalgamating companies is a qualifying company on 1st October 2004 and has not exercised option for tonnage tax scheme within the initial period, then –

(i) the provisions of this Chapter will not apply to the amalgamated company and

(ii) the income of the amalgamated company from the business of operating qualifying ships has to be computed in accordance with the other provisions of the Act.

Demerger [Section 115VZ]

(1) Where in a scheme of demerger, the demerged company transfers its business to the resulting company before the expiry of the option for tonnage tax scheme, then the scheme would apply to the resulting company for the unexpired period if it is a qualifying company.

(2) The option for tonnage tax scheme in respect of the demerged company will remain in force for the unexpired period of the tonnage tax scheme if it continues to be a qualifying company.

(V) Other Provisions

Effect of temporarily ceasing to operate qualifying ships [Section 115VZA]

(1) A temporary cessation (as against permanent cessation) of operating any qualifying ship by a company would not be considered as a cessation of operating of such qualifying ship. The company would still be deemed to be operating such qualifying ship for the purposes of this Chapter.

(2) Where a qualifying company continues to operate a ship ***or inland vessel, as the case may be***, which temporarily ceases to be a qualifying ship, then such ship ***or inland vessel, as the case may be,*** will not be considered as a qualifying ship for the purposes of this Chapter.

(VI) Cases where provisions of this Chapter do not apply

Avoidance of tax [Section 115VZB]

(1) The tonnage tax scheme will not apply where a tonnage tax company is a party to any transaction or arrangement which amounts to an abuse of the tonnage tax scheme.

(2) A transaction or arrangement will be considered as an abuse if the entering into or the application of such transaction or arrangement results, or would, but for this section have resulted, in a tax advantage being obtained by –

(a) a person other than a tonnage tax company; or

(b) a tonnage tax company in respect of its non-tonnage tax activities.

(3) "Tax advantage" includes—

(i) (a) the determination of the allowance for any expense or interest, or

(b) the determination of any cost or expense allocated or apportioned, which has the effect of reducing the income or increasing the loss, as the case may be, from activities other than tonnage tax activities chargeable to tax.

Such computation should be on the basis of entries made in the books of account in respect of the previous year in which the transaction was entered into; or

(ii) a transaction or arrangement which produces to the tonnage tax company more than ordinary profits which might be expected to arise from tonnage tax activities.

Exclusion from tonnage tax scheme [Section 115VZC]

(1) Where a tonnage tax company is a party to any transaction or arrangement which amounts to an abuse of the tonnage tax scheme, the Assessing Officer has the power to exclude such company from the tonnage tax scheme, by an order in writing, after giving an opportunity of being heard to such company.

(2) However, no order to this effect can be passed without the previous approval of the Principal Chief Commissioner or Chief Commissioner.

(3) This section does not apply where the company shows to the satisfaction of the Assessing Officer that the transaction or arrangement was a bona fide commercial transaction and has not been entered into for the purpose of obtaining tax advantage under this Chapter.

Where an order has been passed by the assessing officer excluding the tonnage tax company from the tonnage tax scheme, then the option for tonnage tax scheme shall cease to be in force from the first day of the previous year in which the transaction or arrangement was entered into.

(6) Companies under Liquidation [Sections 178]

(i) Notice to Assessing Officer: Every person

(a) who is the liquidator of any company which is being wound up, whether under the orders of a Court or otherwise, or

(b) who has been appointed as the receiver of any assets of a company

is bound under a statutory obligation to give notice of his appointment as liquidator or receiver, as the case may be. This notice may be given within thirty days of his appointment to the Assessing Officer having jurisdiction to assess the income of the company.

(ii) Information of tax due by the Assessing Officer: The Assessing Officer, in his turn is bound after making such enquiries or calling for such information as he may deem fit, to notify to the liquidator, within three months from the date of receipt of the notice of appointment, of the amount which in his opinion would be sufficient to provide for any tax which is then or likely thereafter to become payable by the company.

(iii) **Restriction on liquidator to part with assets:** The liquidator is debarred from parting with the assets of company and its properties in his hands until he is notified by the Assessing Officer of the amount which will be sufficient to provide for any tax which is then, or is likely thereafter, to become payable by the company except with the prior approval of

- the Principal Chief Commissioner or
- Chief Commissioner or
- Principal Commissioner or
- Commissioner

and on being so notified, shall set aside an amount equal to the amount notified.

However, the above restriction of debarring the liquidator from parting with assets or properties shall not be applicable on

- payment of the tax payable by the company,
- payment to secured creditors whose debts are entitled under law to priority of payments over the debts due to the Government on the date of liquidation and
- meeting such costs and expenses of the winding up of the company

as are, in the opinion of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or the Commissioner, reasonable.

(iv) **Consequences of failure to give notice or set aside the tax due by the liquidator:** If the liquidator fails to notify the Assessing Officer of his appointment within the time specified or fails to set aside the amount intimated by the Assessing Officer as being sufficient to provide for the tax liability of the company or parts with any of the assets or property of the company in his hands in contravention of the above provisions, he shall be personally liable for payment of the tax which the company would be liable to pay.

However, if the amount of any tax payable by the company is notified by the Assessing Officer, the personal liability of the liquidator under this sub-section shall be to the extent of such amount.

Failure to comply with the above requirement would be an offence punishable under section 276A.

Where there are more liquidators than one, their obligations and liabilities under this section are joint and several.

(v) Overrides other laws except IBC, 2016: The provisions of this section have the effect of over-riding anything to the contrary contained under the Companies Act or any other law for the time being in force and apply to all companies, public or private except the provisions of Insolvency and Bankruptcy Code, 2016.

(7) Liability of directors of private company [Section 179]

(i) Liability of directors: Where any tax due from a private company in respect of any income of any previous year or from any other company in respect of any income of any previous year during which such other company was a private company cannot be recovered, then, every person who was director of a private company at any time during the relevant previous year shall be jointly and severally liable for the payment of the tax unless he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company.

The personal liability imposed by this section on the directors of a private company shall have the effect of over-riding any provision under the Companies Act, 2013 by which the liability of the directors is reduced or curtailed. Thus, personal liability can be imposed by the Assessing Officer on a direction even without any adjudication by a Court.

(ii) Meaning of Tax Due: For the purposes of this section, "tax due" includes penalty, interest, fees or any other sum payable under the Income-tax Act, 1961.

9.2 TAXATION OF OTHER ENTITIES

ALTERNATE MINIMUM TAX (AMT) [CHAPTER XII-BA–SECTIONS 115JC TO 115JF]

(i) Applicability: Any person other than a company, who has claimed deduction under any section (other than section 80P) included in Chapter VI-A under the heading "C – Deductions in respect of certain incomes" or under section 10AA or under section 35AD would be subject to AMT **[Section 115JEE(1)]**.

The provisions of AMT would, however, not be applicable to an individual, HUF, AOPs, BOIs, whether incorporated or not, or artificial juridical person, if the adjusted total income of such person does not exceed ₹ 20 lakh **[Section 115JEE(2)]**.

(ii) Levy of AMT@18.5% on Adjusted Total Income: Accordingly, where the regular income-tax payable by a person, other than a company, for a previous year computed as per the provisions of the Income-tax Act, 1961 (other than Chapter XII-BA) is less than the AMT payable for such previous year, the adjusted total income shall be deemed to be the total income of the person. Such person shall be liable to pay income-tax on the adjusted total income @ 18.5% **[Section 115JC(1)]**.

(iii) **Meaning of Adjusted Total Income:** "Adjusted total income" would mean the total income before giving effect to Chapter XII-BA i.e., AMT provisions as increased by the deductions claimed, if any, under –

(1) any section (other than section 80P) included in Chapter VI-A under the heading "C – Deductions in respect of certain incomes" (Section 80-IA to 80RRB);

(2) section 10AA (SEZ); and

(3) section 35AD, **as reduced** by the depreciation allowable under section 32, as if no deduction under section 35AD was allowed in respect of the asset for which such deduction is claimed.

(iv) **Furnishing Report by Chartered Accountant:** Such persons to whom this section applies should obtain a report in prescribed Form 29C from a Chartered Accountant certifying that the adjusted total income and the AMT have been computed in accordance with the provisions of this Chapter. The report has to be furnished on or before the specified date referred to in section 44AB (i.e., one month prior to the due date for filing return of income), in such form as may be prescribed, from an accountant referred to in the Explanation below section 288(2), 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 by that date.

(v) **Levy of AMT @9%/15% of Adjusted Total Income in case of a unit located in IFSC or co-operative society:**

Where the person subject to AMT	Rate of AMT on adjusted total income
- is a unit located in an International Financial Services Centre (IFSC) deriving its income solely in convertible foreign exchange or	9%
- a co-operative society	15%

(vi) **Applicability of Interest and Penal provisions:** Section 115JE specifically provides that "save as otherwise provided in this Chapter, all other provisions of this Act shall apply to a person referred to in this Chapter". Hence, all other provisions relating to self-assessment under section 140A, advance tax, interest under sections 234A, 234B and 234C, penalty etc. would also apply to a person who is subject to AMT.

(vii) Non-applicability of AMT provisions: The provisions of this section shall not apply to a person

- a resident co-operative society who has opted for section 115BAD or 115BAE or
- where income tax payable in respect of total income of such person is computed as per section 115BAC(1A) [Section 115JC(5)].

AMT provisions are also not applicable to Specified fund referred to in section 10(4D).

(Section 115BAC, 115BAD and 115BAE are discussed later on in this chapter)

Tax credit for AMT [Section 115JD]

(i) AMT paid in excess of the regular income-tax payable under the provisions of the Income-tax Act, 1961 for the year would be eligible for credit to be carried forward and set-off against income-tax payable in the later year to the extent of excess of regular income-tax payable under the provisions of the Act over the AMT payable in that year. The balance tax credit, if any, shall be carried forward to the next year for set-off in that year in a similar manner.

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 alternate minimum tax payable, exceeds the amount of the tax credit admissible against the regular income-tax payable by the assessee, then, while computing the amount of credit under this sub-section, such excess amount shall be ignored.

In other words, the amount of tax credit in respect of AMT shall not be allowed to be carried forward to subsequent year to the extent such credit relates to the difference between the amount of foreign tax credit (FTC) allowed against AMT and FTC allowable against the regular tax payable by the assessee.

(ii) AMT credit can be carried forward for set-off upto a maximum period of **15 assessment years** succeeding the assessment year in which the credit becomes allowable.

(iii) No interest shall, however, be payable on such tax credit.

(iv) If the amount of regular income-tax or AMT is reduced or increased as a result of any order passed under the Income-tax Act, 1961, the amount of tax credit allowed under section 115JD would also vary accordingly.

(v) The provisions of AMT credit shall not apply to a person

- a resident co-operative society who has opted for section 115BAD or 115BAE or
- where income tax payable in respect of total income of such person is computed as per section 115BAC(1A) [Section 115JD(7)].

Tax Credit allowable even if Adjusted Total Income does not exceed ₹ 20 lakh in the year of set-off [Section 115JEE(3)]

The credit for tax paid under section 115JC shall be allowed in accordance with the provisions of section 115JD, notwithstanding the conditions mentioned in sub-section (1) or (2) of section 115JEE. Hence, even if the assessee has not claimed any deduction under section 10AA or section 35AD or Chapter VI-A under the heading "C- Deductions in respect of certain incomes" in any previous year and the adjusted total income of that year does not exceed ₹ 20 lakh, it would still be entitled to set-off his brought forward AMT credit in that year.

Related Provisions

(i) Correspondingly, under section 140A, for determination of self-assessment tax payable, tax credit claimed to be set-off in accordance with section 115JD has also to be reduced.

(ii) Such tax credit allowed to be set-off in accordance with the provisions of section 115JD has to be reduced from the amount of tax on total income determined under section 143(1) or on regular assessment, on which interest under section 234A is leviable for default in furnishing return of income.

(iii) Similarly, section 234B levies interest for default in payment of advance tax, to enable reduction of tax credit under section 115JD while computing "assessed tax".

(iv) Likewise, in section 234C levying interest for deferment of advance tax, such tax credit under section 115JD has to be reduced for computing "tax due on the returned income".

ILLUSTRATION 6

Mr. Rajesh has income of ₹ 45 lakhs under the head "Profits and gains of business or profession". One of his businesses is eligible for deduction @100% of profits under section 80-IB for A.Y. 2026-27. The profit from such business included in the business income is ₹ 20 lakhs. Compute the tax payable by Mr. Rajesh, assuming that he has no other income during the P.Y. 2025-26 and he has exercised the option to shift out of default regime under section 115BAC.

SOLUTION

Computation of regular income-tax payable under the provisions of the Act

Particulars	₹
Profits and gains of business or profession	45,00,000
Gross total Income	**45,00,000**
Less: Deduction under section 80-IB	20,00,000
Total Income	**25,00,000**

Tax payable	
Up to ₹ 2,50,000	Nil
5% on next ₹ 2,50,000	12,500
20% on next ₹ 5,00,000	1,00,000
30% on balance ₹ 15,00,000	4,50,000
	5,62,500
Add: Health and education cess@ 4%	22,500
Tax liability	**5,85,000**

Computation of Alternate Minimum Tax (AMT)

Particulars	₹
Total Income as per the regular provisions of the Income-tax Act, 1961	25,00,000
Add: Deduction under section 80-IB	20,00,000
Adjusted Total Income	**45,00,000**
AMT @ 18.5% of ₹ 45,00,000	8,32,500
Add: Health and Education Cess @ 4%	33,300
AMT liability	**8,65,800**

Since the regular income-tax payable as per the provisions of the Act is less than the AMT, the adjusted total income of ₹ 45 lakhs would be deemed to be the total income of Mr. Rajesh and he would be liable to pay tax @18.5% thereof. The tax payable by Mr. Rajesh for the A.Y. 2026-27 would, therefore, be ₹ 8,65,800.

Mr. Rajesh would be eligible for credit to the extent of ₹ 2,80,800 [₹ 8,65,800 – ₹ 5,85,000] to be set-off in the year in which tax on total income computed under the regular provisions of the Act exceeds the AMT. Such credit can be carried forward for succeeding 15 assessment years.

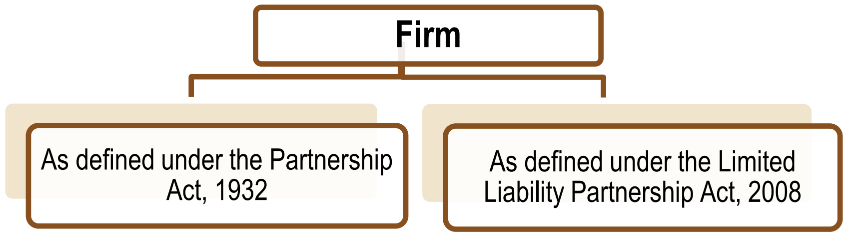
TAXATION OF FIRMS/LLPs AND THEIR PARTNERS

A firm is to be assessed as a unit and the share income from the firm in the hands of the partners is exempt. There is no need for registration.

(i) Meaning of Firm/LLP

Under section 2(23) of the Income-tax Act, 1961, the terms 'firm', 'partner' and 'partnership' have the same meanings respectively as have been assigned to them under the Indian Partnership Act, 1932, but the expression 'partner' also includes any other person who being a minor, has been admitted to the benefits of an existing partnership. In addition, the definitions also include the terms limited liability partnership, a partner of limited liability partnership as they have been defined in the Limited Liability Partnership Act, 2008.

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



A firm though not a legal person or juridical entity, is chargeable to tax as a separate entity distant from the partners and the partners are assessable as individuals and not as an association persons or body of individuals. The term 'firm' as used in the Act covers both registered and unregistered firms.

(ii) Residential Status of Firm/LLP

The residential status of a firm to be determined depending upon the fact whether or not the control and management of its affairs is exercised from within India. Even if the negligible part of the control and management is exercised from within India, the firm would be resident in India for all the purposes. For determining the residential status of a firm, it is immaterial to ascertain the residential status of partners thereof because a firm may be resident even in cases where all the partners are not resident in India and they control or manage the affairs from India.

(iii) Tax Rate of Firm/LLP

Every firm is liable to pay tax flat rate of 30% on its total income of the previous year computed in accordance with the provisions of the Act, ***plus*** surcharge @12% if its total income exceeds ₹ 1 crore *plus* health and education cess @4%.

Salient features of assessment of partnership firms
The following are the salient features of assessment of partnership firms: (a) The firm will be taxed as a <u>separate entity</u>. There will be no distinction between registered and unregistered firm.

(b) The share of the partner in the income of the firm will not be included in the hands of the partner. It will be exempt under section 10(2A).

(c) Any salary, bonus commission or remuneration, by whatever name called, which is due to or received by a partner will be allowed as a deduction subject to certain restrictions.

(d) Where a firm pays interest to any partner, the firm can claim deduction of such interest from its total income subject to certain conditions. However, the maximum rate at which interest can be allowed to a partner will be 12% per annum.

(e) The income of the firm will be taxed at a flat rate of 30% plus surcharge **@12%** if its total income exceeds ₹1 crore plus health and education cess @4%.

(iv) Assessment as firm [Section 184]

- **Conditions to be fulfilled:**

To get the status of PFAS, the firm should be evidenced by an "instrument". The word "instrument" means a document of legal nature by which any right or liability is created, limited, extended, or extinguished.

Instrument does not necessarily mean a regular partnership deed, but it may constitute any other relevant document. If the terms of a partnership are contained in a number of documents or in the correspondence between the parties, the documents or letters would constitute "instrument" for the purposes of section 184(1)(i).

The next condition is that the individual shares of partners must be specified in the instrument. A firm cannot get the status of PFAS unless the instrument of partnership specifies the individual shares of partners in the profits of the partnership. Evidence regarding the shares of partners should be available within the framework of the instrument. It should not involve searching of a number of documents.

The next condition is that a certified copy of the instrument should accompany the first return of income of a firm. As already noted, "instrument" in this sense refers not only to the partnership deed but also other documents from which the existence of partnership can be proved. Accordingly, certified copies of all documents will have to be submitted. Section 184 requires that the copy of the instrument shall be certified in writing by all partners other than minors. If, however, the return is made after the dissolution of the firm, it should be certified by all partners other than minors who were partners in the firm immediately before dissolution and by the legal representative of any such partner who is deceased. The certified copy of the instrument of partnership shall accompany the return of income of the firm of the previous year relevant to the assessment year.

If there is any change in the constitution of the firm or profit-sharing ratio during any previous year, a certified copy of the revised instrument of partnership should be filed along with the return of income of the relevant assessment year. Even if there is a change in remuneration/payment of interest to partners but there is no change in profit sharing ratio, a copy of the revised instrument of partnership should be submitted along with return to comply with the provisions of section 40(b).

Section 184(5) provides that where the firm commits any default as mentioned in section 144 *(Best Judgment assessment - Refer Chapter 15: Assessment Procedure for detailed discussion),* the firm shall be so assessed that no deduction for payment of interest, salary, bonus, commission or remuneration, by whatever name called, made by the firm to any partner shall be allowed in computing the income chargeable under the head "Profits and gains of business or profession". However, the interest, salary, bonus, commission or remuneration so disallowed shall not be charged to tax in the hands of the partners under section 28(v).

Partnership Firm assessed as Firm [PFAS] – If

- the firm is evidenced by an "instrument".
- individual shares of partners are specified in the instrument
- a certified copy of the instrument accompany the first return of income of a firm
- a certified copy of the revised instrument of partnership filed along with the return of income of the relevant assessment year

♦ **Computation of income of partnership firm**: While computing the income of a firm assessed as such, we have to keep in mind the following points:

(a) Remuneration is to be allowed

(b) Interest is to be allowed

(c) Unabsorbed depreciation and other losses should be provided for.

- **Remuneration paid to partners**: First let us discuss the question of deduction of remuneration to the partners. In this context we have to remember the conditions prescribed by section 37 as regards the allowability of residuary expenses. Accordingly, no capital expenditure or personal expenses will be allowed. Further the remuneration paid must be only and exclusively for the purposes of the business of the firm. Apart from the general conditions prescribed in section 37 there are certain specific conditions prescribed by section 40(b).

They are as follows: -

(1) Such remuneration should be paid only to the working partner.

(2) It should be authorised by the partnership deed.

(3) It should not pertain to a period prior to partnership deed.

(4) It should not exceed the permissible limit.

(1) Payment should be to a working partner:

Explanation 4 to section 40(b) defines working partner as one who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner. This definition is very general. It seems that a partner can be a working partner in more than one firm. If a partner is employed somewhere else too, he can still be a working partner in the firm. However, in all such situations the partner must in fact be a working partner in the firm. In other words, merely because a person is working somewhere else too, such a fact does not by itself debar him from being a working partner in a firm in which he is a partner. As stated before, to be a working partner, the partner has to be actively engaged in conducting the affairs of the business or profession of the firm. Now in order to be actively engaged in conducting the affairs of the business or profession does not require either expressly or by implication that the concerned partner should be so actively engaged in conducting the business affairs on a full-time basis. A partner can be said to be actively engaged in conducting the affairs of the firm even if he devotes a part and not the whole of his working hours.

Further, in order to be actively engaged in the affairs, a partner is not expected to be engaged in the whole of the affairs of the business of the firm, nor is he expected to know everything about the affairs of the business of the firm. For example, in a firm with many partners, one partner may be looking after purchases, another after sales and another after production and still another after administration, finance and accounts. It cannot be contended that just because they are not overall in charge, they cannot be considered as working partner.

Another significant point to be noted here is that the definition of "working partner" in *Explanation 4* contemplates an individual. Therefore, a partner other than an individual (example a company) cannot be working partner. An interesting situation may be considered here. When a company is a partner in a firm, a director or shareholder of the company can very well be an employee of the firm in which the company is a partner. Any salary/remuneration paid by the firm to such an employee would be totally outside the ambit of disallowance under section 40(b). This would be so because the individual who is an employee of the firm is not a partner in the firm. It is the company in which he is the director, which is the partner and, section 40(b) contemplates allowance of remuneration paid by a firm to its partners and not to other employees.

(2) It should be authorised by the Partnership Deed:

Any payment of salary, bonus, commission or remuneration by whatever name called to a working partner is not allowed as a deduction if the payment is not authorised by partnership deed or it is not in accordance with the terms of partnership deed. As a result, a mere general authority in the partnership deed that such and such working partners would be paid remuneration as may be agreed upon between the partners from time to lime will not be sufficient. The partnership deed will have to contain clear direction as to the quantum of remuneration to be paid to the working partners. The CBDT had, vide *Circular No. 739 dated 25-3-1996*, clarified that **no deduction under section 40(b)(v) will be admissible unless the partnership deed either specifies the amount of remuneration payable to each individual working partner or lays down the manner of quantifying such remuneration.** For example, such remuneration may be specified by way of annual fixed payment or as a certain specified percentage of the firm's book profit at the year end. It may be noted that such remuneration need not be paid on a monthly basis. An item like commission can be paid even as a percentage of sales. Remuneration also can be yearly payment.

Now, a question arises whether the names of individual working partners should be specified in the partnership deed or whether it is sufficient if the total remuneration payable to the working partners as a whole is indicated. One opinion is that it is not necessary that individual partners should be identified or designated. It will be sufficient to lay down an authorisation in the deed to the effect that remuneration will be payable to the class of working partners up to so and so percentage of the book profit. And further that, within such limits, the working partners shall share such remuneration in any ratio as may be agreed upon. In other words, this concept gives recognition to the working partners as a class and authorising remuneration for the class rather than identifying or designating individual working partners and authorising remuneration for each individual working partner. There is nothing in section 40(b) which prohibits this type of interpretation. However, in order to avoid litigation, it is better that the deed identifies and designates the working partners as well as the remuneration payable to them.

As a result of this stipulation, every firm constituted on or after April 1, 1992 will have to provide for an appropriate clause in its partnership deed satisfying this requirement. However, so far as the existing firms are concerned, they will have to execute a supplementary deed or a deed of change in the constitution so as to incorporate a clause within the deed of partnership relating to payment of remuneration to its working partners.

(3) It should not pertain to period prior to partnership deed:

By virtue of a further restriction contained in 40(b)(iii), such remuneration paid to the working partners will be allowed as deduction to the firm from the date of such partnership deed and not from any period prior thereto. Consequently, if for instance a firm incorporates the clause relating to payment of remuneration to the working partners by executing an appropriate deed as on July 1st, but effective from April 1st, the firm would get deduction for the remuneration paid to its working partners from July 1st onwards but not for the period from April 1st to June 30th. In other words, it will not be possible to give retrospective effect to oral agreements entered into *vis-a-vis* such remuneration prior to putting the same in a written partnership deed.

ILLUSTRATION 7

A and B entered into partnership agreement on April 1, 2025. As per the deed, each of them will be entitled to salary of ₹ 2,000 per month apart from profit. On August 1, 2025, they executed a supplementary deed by which they increased the remuneration to ₹ 3,000 each effective from 1st April 2025. Discuss the validity of the supplementary deed.

SOLUTION

Remuneration will be payable effectively from the date of the deed which provides for the payment of such remuneration. In the given case, the original deed provides for remuneration at the rate of ₹ 2,000 for each partner from April 1, 2025 onwards. The supplementary deed is executed on August 1, 2025 increasing the limit of remuneration. Such an increase in the limit of remuneration will be allowable only from 1st August 2025, being the date of supplementary deed. Hence, for the period from 1st April 2025 to 31st July 2025, the partners will be allowed remuneration only at the rate of ₹ 2,000 per month.

(4) It should not exceed the permissible limit:

As we have seen earlier, salary, bonus, commission or other remuneration may be paid to any working partner in accordance with and as authorised by the terms of the partnership deed and in relation to any period falling after the partnership deed. However, the maximum amount of such payment to all the partners during the previous year should not exceed the limits given below:-

Book Profit	Quantum of Deduction
On the first ₹ 6 lakh of book profit or in case of loss	₹ 3,00,000 or 90% of book profit, whichever is higher
on the balance of book profit	60% of book profit

Book Profit:

The permissible remuneration is to be computed as a percentage of book profit. For this purpose, we have to draw up the profit and loss account and find the net profit. This profit and loss account is to be prepared in the manner laid down in Chapter IV-D. It may be noted that Chapter IV-D contains the provisions relating to computation of income under the head 'Profits and gains of business or profession'. Further, *Explanation 3* also lays down that if while arriving at the above net profit, the remuneration paid/payable by a firm to its partners is debited to such a profit and loss account, **the aggregate of such remuneration paid/payable to the partners shall be added to the net profit in order to arrive at the book profit**.

When the Act says that the profit and loss account should be prepared in the manner laid down in Chapter IV-D, it means that only those items which are chargeable under section 28 as income will be taken into account and only deductions permissible thereunder will be allowed.

For example, rent from house property, dividend, interest on bank deposit or government securities are not chargeable as income from business or profession under section 28. Therefore, if the profit and loss account of a firm contains these receipts, they have to be excluded while calculating the net profit.

In the same way, items which are to be disallowed under the various provisions from sections 28 to 44D will have to be eliminated. It naturally follows, therefore, that brought forward business losses will not be deducted while calculating book profit.

In simple terms, 'book profit' means income computed under the head "Profits and gains of business or profession" before deduction of partners remuneration. **Accordingly, unabsorbed depreciation can be set-off under section 32(2) against such income to arrive at the book profit, but not unabsorbed business loss under section 72.**

The above table shows the upper limits up to which deduction is allowed to firm in respect of the remuneration paid to its working partners. It does not mean that a firm is prohibited from paying remuneration beyond these limits. A firm can pay remuneration to working partners beyond these limits, but it will suffer disallowance in respect of such excess under section 40(b) and consequently pay tax on it @30%. If a firm pays remuneration to non-working partners, the same will be the result. However, the above limits apply to the remuneration paid to the group of all working partners in a firm taken together and not to each individual partner. Finally, it may be noted that section 40(b) does not compel a firm to pay remuneration to its working partners. It is purely at the discretion of the firm. However, once a firm pays remuneration to its working partners it will be subject to the restrictive provisions of section 40(b). It is also open to a firm to pay salary only to a few working partners and not all the working partners.

- **Interest payable to partners:** So far as allowability of interest paid by a firm to its partners under section 40(b) is concerned, the following conditions have been prescribed by section 40(b):

  (1) The interest payable by a firm to its partners should be **authorised by and in accordance with the partnership deed.**

  (2) The interest payable by a firm to its partners should **not be for a period falling prior to the date of such partnership deed** authorizing the payment of such interest.

(3) The rate of interest payable to the partners **<u>shall not exceed 12% simple interest per annum</u>.**

An important question could be regarding the amount with reference to which this interest @12% will have to be calculated. For example, a partner may have contributed capital to the firm and in addition may also advance loan to the firm. The question would be whether the interest paid by the firm on capital would be allowable or that on the loan would be allowable. Moreover, some firms have an accounting system of maintaining current accounts of partners in addition to the capital accounts. When some balance is standing to the credit of a partner in such current account as well the question arises whether the interest paid on the balance in the current account will be allowable within the meaning of section 40(b).

In this regard, it may be noted that section 40(b) does not refer to nor does it make any distinction between the capital contributed by a partner to the firm, the loan advanced by a partner to the firm or the balance in the current account of a partner. Therefore, the **<u>interest paid by a firm to its partners on the credit balance standing in all the accounts/whether in capital account, loan account or current account, shall be allowed as deduction to the firm under section 40(b)</u>.** The idea seems to be to allow interest on the funds employed in the firm by a partner.

As it happens, many a time, a partner may have debit balance in his current account and credit balance in his capital account or loan account. The question which would arise in such a situation could be whether the interest payable to such a partner at the rate of interest authorised by and in accordance with partnership deed will be reckoned with reference to the aggregate of the credit balance in the capital account and the loan account including the debit balance in the current account or whether it should be calculated on the net balance that is the aggregate of the credit balance in the capital account and in the loan account as reduced by the debit balance in the current account. It appears that in such a situation the equitable principle would be to allow interest reckoned with reference to the net balance. Alternatively, if interest is recovered from a partner on the debit balance in his account and interest is paid to the same partner on the credit balance in his account, the net amount paid to that partner would be subjected to the provisions of section 40(b). However, interest received from one partner cannot be set-off against interest paid to another partner.

The next issue which is to be considered here is the point of time at which interest should be credited to the partners' accounts. For example, a firm may adopt a policy of crediting interest quarterly to the credit of the partners' accounts. In such a case, the firm would be paying in effect interest on interest at the year end. This would amount to compounding interest quarterly. This is not permitted under section 40(b) because what that section contemplates is simple interest and simple interest here would mean interest which is calculated yearly or annually. Paying the interest on interest credited periodically during a year would be contrary to the concept of simple interest per annum.

- **Partner in a representative capacity**: If an individual is a partner in a firm in a representative capacity (that is on behalf and for the benefit of another person) and not in his personal capacity then, interest paid by the firm to such individual in his personal capacity and not as a representative capacity will not be subject to the conditions and ceiling as prescribed for disallowance. But interest paid by the firm to such individual as representative partner or person represented shall be subject to the conditions and ceiling as prescribed *[Explanation 1 to section 40(b)]*.

> ***Example:*** *X is a partner in a firm in a representative capacity for and on behalf of his HUF. Supposing the firm pays interest of ₹ 6,000 to X in his personal capacity and not in his capacity as the representative of HUF, it will be allowed as deduction and the prescribed ceiling will not apply. However, if such payment is made to X as a representative partner or if the firm has paid the interest directly to HUF, then the payment will be subject to the conditions and ceiling as prescribed.*

- **Interest received by a non-representative partner**: If interest is paid to an individual partner who is not the representative partner and the interest received by him is on behalf of or for the benefit of another person, then such interest payment shall be allowed without applying the ceiling limits *[Explanation 2 to section 40(b)]*.

> ***Example:*** *X is a partner of a firm in his individual capacity and is not a representative partner. Interest is paid by the firm to him in respect of a deposit made by his wife. This will be allowed as a deduction because such interest is received by him purely on behalf of another person.*

- ***TDS on salary, remuneration, commission, bonus or interest to partner****: Firm is responsible to deduct tax @10% on any sum in the nature of salary, remuneration, commission, bonus or interest paying to its partner.*

  The deduction of tax has to be made at the time of crediting such sum to the account of the partner (including the capital account) or at the time of its payment, whichever is earlier.

No deduction of tax shall be made where such sum or the aggregate of such sums credited or paid or likely to be credited or paid to the partner of the firm does not exceed ₹ 20,000 during the financial year.

ILLUSTRATION 8

M/s. HIG, a firm, consisting of three partners namely, H, I and G, carried on the business of purchase and sale of television sets in wholesale and manufacture and sale of pens under a deed of partnership executed on 1.4.2014. H, I and G were partners in their individual capacity.

The deed of partnership provided for payment of salary amounting to ₹ 1,25,000 each to H and G, who were the working partners. A new deed of partnership was executed on 1.10.2025 which, apart from providing for payment of salary to the two working partners as mentioned in the deed of partnership executed on 1.4.2014, for the first time provided for payment of simple interest @12% per annum on the balances standing to the credit of the Capital accounts of partners from 1.4.2025.

The firm was dissolved on 31.3.2026 and the capital assets of the firm were distributed among the partners on 20.4.2026. The net profit of the firm for the year ended 31.3.2026 after payment of salary to the working partners and debit/credit of the following items to the Profit and Loss Account was ₹ 3,50,000:

(i) *Interest amounting to ₹ 1,00,000 paid to the partners on the balances standing to the credit of their Capital accounts from 1.4.2025 to 31.3.2026.*

(ii) *Interest amounting to ₹ 50,000 paid to the partners on the balances standing to the credit of their Current accounts from 1.4.2025 to 31.3.2026.*

(iii) *Interest amounting to ₹ 20,000 paid to the Hindu undivided family of partner H @ 18% per annum.*

(iv) *Payment of ₹ 25,000 towards purchase of television sets (stock in trade) made by crossed cheque on 1.11.2025.*

(v) *₹ 30,000 being the value of gold jewellery received as gift from a manufacturer for achieving sales target.*

(vi) *Depreciation amounting to ₹ 15,000 (as per Income-tax Rules) on motor car bought and used exclusively for business purposes but registered in the name of partner 'H'.*

(vii) *Depreciation under section 32(1)(ii) amounting to ₹ 37,500 of new machinery bought and installed for manufacture of pens on 1.11.2025 at a cost of ₹ 5,00,000.*

(viii) *Interest amounting to ₹ 25,000 received from bank on fixed deposits made out of surplus funds.*

The firm furnishes the following information relating to it:

(a) *Closing stock-in-trade was valued at ₹ 60,000 as per the method of lower of cost or net realizable value consistently followed by it. The net realizable value of the closing stock-in-trade was ₹ 65,000.*

(b) *Brought forward business loss relating to the assessment year 2025-26 was ₹ 50,000.*

(c) *The fair market value of the capital assets as on 20.4.2026 was ₹ 20,00,000 and the cost of their acquisition was ₹ 15,00,000.*

Compute the total income of M/s. HIG for the Assessment Year 2026-27.

You are required to furnish explanations for the treatment of the various items given above.

SOLUTION

Computation of total income of M/s. HIG for the A.Y. 2026-27

Particulars	₹	₹
Net profit as per profit & loss account		3,50,000
Add: Interest to partners on capital accounts for the period from 1.4.2025 to 30.9.2025 disallowed (total interest ₹ 1,00,000 but deduction limited to 6 months only hence 50% thereof is deductible and the balance is added) **[Note (i)]**	50,000	
Interest to partners on current accounts from 1.4.2025 to 31.3.2026 – not authorized by the deed, hence disallowed **[Note (ii)]**.	50,000	
100% of ₹ 25,000 paid towards purchase of television sets 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 or through such other electronic mode as may be prescribed (being stock in trade, hence disallowed) **[Note (iv)]**.	25,000	

Difference on account of valuation of closing stock-in-trade at net realisable value (₹ 65,000 less ₹ 60,000) **[Note (ix)]**	5,000	
Salary paid to working partners considered separately.	2,50,000	3,80,000
		7,30,000
Less: Additional depreciation on new machinery (₹ 5,00,000 x 20%) = ₹ 1,00,000. Only 50% is allowable as deduction. **[Note (vii)]**		50,000
		6,80,000
Less: Interest received from bank on fixed deposits considered separately		25,000
		6,55,000
Less: Salary to working partners -		
(i) As per limit in section 40(b)		
On first ₹ 6,00,000 @ 90%	5,40,000	
On the balance of ₹55,000 @ 60%	33,000	
	5,73,000	
(ii) Salary actually paid	2,50,000	
Deduction allowed being (i) or (ii), whichever is less		2,50,000
		4,05,000
Less: Business loss relating to A.Y. 2025-26 set off		50,000
Income from business		**3,55,000**
Income from other sources		
Interest received from bank on fixed deposits **[Note (viii)]**.		25,000
Total Income		**3,80,000**

Notes:

(i) Interest to partners authorised by the partnership deed will be allowed as deduction only for the period beginning with the date of the partnership deed and not for any earlier period as per section 40(b)(iv). Therefore, interest paid to the partners on the balances standing to the credit of their capital accounts from 1.10.2025 alone is eligible for deduction, since the partnership deed was executed only on 1.10.2025. Interest for the period prior to 1.10.2025 is not allowed.

(ii) The partnership deed of 1.10.2025 provides for payment of interest on balances in capital accounts of partners only. As such, the interest paid on the balances standing to the credit of the current accounts of partners is not allowable under section 40(b). The Kerala High Court has, in *Novel Distributing Enterprises v. DCIT (2001) 251 ITR 704 (Ker)*, on identical facts, held that interest paid to the partners on their current account balances is not allowable.

(iii) Since H is a partner in his individual capacity, interest paid to the Hindu Undivided Family of partner H does not attract disallowance under section 40(b)(iv). Also, assuming that the provisions of section 40A(2) do not get attracted in this case, such interest shall be allowed as deduction in full even though the interest rate is more than 12% p.a.

(iv) Section 40A(3) provides for disallowances @100% of the expenditure incurred for an amount exceeding ₹ 10,000 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 or through such other electronic mode as may be prescribed. Since the firm has made payment of ₹ 25,000 towards purchase of television sets by a crossed cheque and not by an account payee cheque, 100% of such expenditure would be disallowed.

(v) Gold jewellery valued at ₹ 30,000 received as gift from a manufacturer for achieving sales target is taxable under section 28(iv), being a benefit arising from business. Since it has already been credited to profit and loss account, no further adjustment is required.

(vi) Depreciation on motor car bought and used exclusively for the purposes of business is allowable though not registered in the name of the firm in view of the ratio of the decision of the Supreme Court in *Mysore Minerals Ltd. v. CIT (1999) 239 ITR 775*.

(vii) The firm is entitled to additional depreciation @ 20% under section 32(1)(iia) in respect of the new machinery installed for manufacture of pens. Since the new machinery is put to use for less than 180 days during the relevant previous year, the additional depreciation is restricted to 50% of the prescribed rate of 20% i.e., it is restricted to 10%. The balance additional depreciation can be claimed in the immediately succeeding financial year.

(viii) Interest received from bank on fixed deposits made out of surplus funds is assessable under the head 'Income from other sources'. Hence, it is not taken into account for the purpose of computing book-profit.

(ix) As per para 24 of ICDS II: Valuation of Inventories, closing stock has to be valued at net realizable value in the case of a dissolved firm. As such, the closing stock-in-trade of the firm has to be valued at the net realizable value of ₹ 65,000. Since it has been valued at ₹ 60,000, being the cost, the balance ₹ 5,000 has to be added.

(x) Net profit shown in the profit and loss account computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to all the partners constitutes book profit as per *Explanation 3* to section 40(b). Carry forward and set off of business loss is covered under Chapter VI. Hence, brought forward business loss relating to the assessment year 2025-26 is not considered for calculation of book-profit.

(xi) Section 9B would be attracted in the hands of M/s HIG in the A.Y. 2027-28, since capital assets are received by the partners on 20.4.2026, i.e., P.Y. 2026-27.

- **Computation of income of partner of a firm (PFAS)**: While computing the income of a partner including a minor partner of a firm, the following points have to be taken into consideration.

  Share income exempt under section 10(2A): The partner's share in the total income of firm (PFAS) will be exempt in his hands and will not be included in his total income. His share in the total income of the firm will be calculated as follows: -

$$\text{Total income of firm} \times \frac{\text{Partner's share in profits of firm as per partnership deed}}{\text{Total profit of the firm}}$$

  By virtue of this exemption, a partner of PFAS will not be taxed in respect of his share in the firm's income since the firm itself will be taxed as a separate entity @30%. There will be no allocation of income among the partners. On account of this exemption, he will not be entitled to set-off his share in the firm's loss against his other personal income.

  Chargeability of remuneration and interest: Remuneration and interest received by a partner of a PFAS in accordance with the conditions prescribed under section 40(b) will be taxable in his hands as income from profits and gains of business or profession.

If remuneration or interest paid to a partner is disallowed in the assessment of the firm due to the fact that they are not in accordance with the conditions prescribed under section 40(b) then the partner will not be taxed in respect of the amount disallowed because in such a case the firm itself will be liable to pay tax on the amount which has been disallowed in its assessment. In other words, <u>if the firm is given the benefit of deduction of remuneration and interest paid to a partner then the liability to tax in respect of such amount will be that of a partner. If the firm is not given the benefit of deduction because of the non-compliance with the provisions of section 40(b) then the firm itself will be liable in respect of the amount and the partner will not be taxed in respect of it in his personal assessment</u>. It is obvious that such remuneration or interest which has been disallowed in the hands of the firm but actually received by a partner will be assumed to be his share in the income of such firm and exemption under section 10(2A) will operate.

Suppose a portion of the remuneration and interest in the assessment of the firm is disallowed since they exceed the overall ceiling limit prescribed under section 40(b), the question arises as to how to allocate such disallowance in the hands of the partner. One reasonable basis is to assume that the remuneration and interest paid to the partners concerned has been disallowed in proportion to the gross remuneration and interest paid to them and the exemption of the disallowed sum should be available to the partners in the same proportion.

♦ **Assessment of firms – Some of the important issues to be considered by the Assessing Officer while framing assessment [Circular 12/2019, dated 19.6.2019]:**

(i) While computing remuneration which is allowable to a working partner under section 40(b)(v), the term 'in accordance with the terms of the partnership deed' in clauses (ii) and (v) of section 40(b) implies that remuneration should not be undetermined or undecided. Hence, in all situations, partnership deed should form the basis for determination of remuneration payable to the working partners. Furthermore, in situations where the remuneration either so specified in the partnership deed or computed as per the method indicated therein falls short of the amount allowable under section 40(b)(v), it would be restricted to the figure computed on the basis of the partnership deed.

(ii) While computing remuneration payable to the working partners under section 40(b)(v) of the Act, the remuneration should not exceed a particular aggregate amount which is based upon the figure of 'book profit'. *Explanation 3* to section 40(b) contains definition of 'book profit' for the purposes of determination of remuneration of the partners and provides that 'book profit' shall mean the net profit, as shown in the profit & loss account for the relevant previous year, computed in the manner laid down in Chapter IV-D as increased by the aggregate amount of the remuneration paid or payable to all the partners of the firm if such amount has been deducted while calculating the net profit. Therefore, while computing 'book profit' for purposes of section 40(b)(v), all incomes such as capital gain, interest, rental income, income from other sources etc. which do not fall under the head 'Profits and gains of business or profession', should be excluded.

(iii) Under section 185, any non-compliance by the firm or its partners with provisions of section 184 may result in denial of expenses such as remuneration, interest etc. payable to the partners which are otherwise allowable under the provisions of the Act.

(iv) Where firms try to inflate the profits eligible for deduction under section 80-IA by not claiming expenditure towards remuneration, salary, interest etc. which are payable to the partners, the Assessing Officers may examine these transactions in light of provisions of section 80-IA(10) which empower Assessing Officer to re-compute profit of the eligible business after excluding the profits of the related activity/business which produced the excessive profit.

- **Treatment of losses**: If PFAS incurs any loss, the firm alone can set off and forward such losses to be set off against income of the subsequent years. The firm will not be allowed to apportion its unabsorbed losses among its partners.

- **Set off of carry forward loss in case of change in the constitution of the firm [Section 78]**: If there is a change in the constitution of the firm, the loss of a retired/deceased partner can be carried forward by the firm only to the extent that it does not exceed such partner's share in the profits of the firm of the relevant previous year.

However, it is to be carefully noted that section 78 is applicable only in case there is a change in the constitution of the firm as result of <u>retirement or death of a partner in the previous year</u>. In other words, it does not apply when there is a change in the profit-sharing ratio or change in the constitution because of induction of a new partner. Similarly, section 78 **<u>will not apply to set off and carry forward of unabsorbed depreciation</u> etc.**

> ***Example:*** *ABC & Co. is a firm with 3 partners – A, B & C having equal profit-sharing ratio. For the P.Y. 2025-26, the loss from business is ₹ 3,00,000 and unabsorbed depreciation is ₹ 1,50,000. Business loss and unabsorbed depreciation represents the amount after inter-source and inter-head set-off. C retires on 31.03.2026 from the firm. Firm can carry forward business loss of ₹ 2,00,000 (3,00,000 – 1,00,000) and unabsorbed depreciation of ₹ 1,50,000 for set-off against income of subsequent assessment years.*

- **Liability of partner of LLP in liquidation [Section 167C]:** This section provides for the liability of partners of LLP in liquidation. In case of liquidation of an LLP, where tax due from the LLP cannot be recovered, every person who was a partner of the LLP at any time during the relevant previous year will be jointly and severally liable for payment of such tax unless he proves that non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the LLP. This provision would also apply where tax is due from any other person in respect of any income of any previous year during which such other person was a LLP. "Tax due", for the purpose of this section includes penalty, interest or any other sum payable under the Income-tax Act, 1961.

- **Assessment in case of change in constitution, succession and dissolution of a firm [Section 187 to 189A]**

  Change in constitution of a firm: Where at the time of making an assessment under section 143 or 144 it is found that a change has occurred in the constitution of a firm, assessment shall be made on the firm as constituted at the time of making the assessment.

  Meaning of change in constitution of the firm: It means

  (a) If one or more of the partners cease to be partners (other than a case where ceases to be a partner by way of demise of the partner) or one or more new partners are admitted, in such circumstances that <u>one or more</u> of the persons who were <u>partners of the firm before the change continue as partner or partners after the change</u>.

  (b) <u>All the partners of firm continue</u> to be the partner of the firm <u>but there is a change in their profit-sharing ratio</u> or change in shares of some of them.

  Succession of one firm by another: In a case where a firm carrying on a business or profession is succeeded by another firm; separate assessment will be made on the predecessor firm and the successor firm in accordance with the provisions of section 170 [Section 188].

Liability of partners: Where any tax, penalty or other sum payable by the firm for the relevant previous year is due, then every person being a partner of a firm and the legal representative of deceased partner during the previous year shall be jointly and severally liable along with the firm in respect of such sum [Section 188A].

Dissolution of firm or discontinuance of business: Where a firm is dissolved or business or profession is discontinued by the firm, the Assessing Officer shall make an assessment of the total income of the firm as if no discontinuance or dissolution has taken place and all the provisions of the Act relating to levy of a penalty or any other sum chargeable under this Act, shall be applicable accordingly [Section 189].

Every person who was at the time of dissolution or discontinuance a partner of a firm and the legal representative of deceased partner shall be jointly and severally liable for the amount of tax, penalty or other sum payable by the firm and all the provisions of the Act shall apply accordingly. If any proceedings have commenced in respect of any assessment year before dissolution or discontinuance, the proceeding may be continued against such persons (i.e., partner and legal representative) from that stage. The liability of legal representative is limited to the extent to which the estate is capable of meeting the liability.

Tax consequences on transfer of capital asset to a partner on dissolution or reconstitution of a firm *- Section 9B deals with taxability on receipt of capital asset or stock in trade or both by a partner from a firm on dissolution or reconstitution of firm. The taxability of receipt of money or capital asset or both by a partner on reconstitution of a firm is dealt with in section 45(4). Thus, in a case of reconstitution of firm, where a partner receives capital asset from the firm, the provisions of both section 9B and 45(4) are attracted in the hands of the firm. The taxation under these two provisions has to be worked out independently.*

Tax treatment on dissolution of firm is dealt with in section 9B and is not covered under section 45(4). For details, please refer Chapter 4: Capital Gains in Module 1

ILLUSTRATION 9

Vijay Agencies, a partnership firm constituted by three partners with equal shares was dissolved on 1-03-2025 after a search. The tax liability of the firm outstanding to be paid was determined at ₹ 15 lakhs. Out of three partners, one was declared insolvent on 18-03-2026 by the Court. The Assessing Officer, for recovering the demand, *attached the Bank Accounts of other two partners and could recover an amount of ₹ 6 lakhs from the Account of one such partner. You are asked the following questions by the partners of the dissolved firm:*

(i) About the liability of each of them to pay outstanding demand.

(ii) Whether the action of Assessing Officer to attach the Bank Account of partners to recover the tax demand of the dissolved firm is justified?

SOLUTION

As per section 189(3), every person who was at the time of dissolution, a partner of the firm, shall be jointly and severally liable for the amount of tax, penalty or other sum payable and all the provisions of the Act relating to assessment of such tax or imposition of such penalty or other sum, shall apply. Therefore,

(i) the three partners (till one was declared as insolvent by the Court) are jointly and severally liable for making the payment of outstanding dues of ₹ 15 lakhs. After insolvency of one partner, the other two partners are jointly and severally liable to pay such demand.

(ii) Accordingly, the action of the Assessing Officer to attach the bank accounts of the partners for recovery of outstanding demand is correct and the amount of ₹ 6 lakhs recovered by attachment of the bank account of one of the partners is also in order.

♦ **Conversion of company into an LLP**

(i) Consequent to the Limited Liability Partnership Act, 2008 coming into effect in 2009 and notification of the Limited Liability Partnership Rules w.e.f. 1st April, 2009, the Finance (No.2) Act, 2009 had incorporated the taxation scheme of LLPs in the Income-tax Act, 1961 on the same lines as applicable for general partnerships, i.e. tax liability would be attracted in the hands of the LLP and tax exemption would be available to the partners. Therefore, the same tax treatment would be applicable for both general partnerships and LLPs.

(ii) Under section 56 and section 57 of the Limited Liability Partnership Act, 2008, conversion of a private company or an unlisted public company into an LLP is permitted. Consequently, section 47(xiiib) has been inserted under the Income-tax Act, to provide that -

(1) any transfer of a capital asset or intangible asset by a private company or unlisted public company to an LLP; or

(2) any transfer of a share or shares held in a company by a shareholder

on conversion of a company into an LLP in accordance with section 56 and section 57 of the Limited Liability Partnership Act, 2008, shall not be regarded as a transfer for the purposes of levy of capital gains tax under section 45, subject to fulfillment of certain conditions. This clause has been introduced to facilitate conversion of small private and unlisted public companies into LLPs. These conditions are as follows:

(1) the total sales, turnover or gross receipts in business of the company should not exceed ₹ 60 lakhs in any of the three preceding previous years;

(2) all the shareholders of the company immediately before conversion become partners of the LLP in the same proportion as their shareholding in the company;

(3) no consideration other than share in profit and capital contribution in the LLP arises to the shareholders;

(4) the erstwhile shareholders of the company continue to be entitled to receive at least 50% of the profits of the LLP for a period of 5 years from the date of conversion;

(5) The total value of assets as appearing in the books of account of the company in any of the three previous years preceding the previous year in which the conversion takes place, should not exceed ₹ 5 crores;

(6) all assets and liabilities of the company become the assets and liabilities of the LLP; and

(7) no amount is paid, either directly or indirectly, to any partner out of the accumulated profit of the company for a period of 3 years from the date of conversion.

(iii) However, if subsequent to the transfer, any of the above conditions are not complied with, the capital gains not charged under section 45 would be deemed to be chargeable to tax in the previous year in which the conditions are not complied with, in the hands of the LLP or the shareholder of the predecessor company, as the case may be [section 47A(4)].

(iv) Further, the successor LLP would be allowed to carry forward and set-off the business loss and unabsorbed depreciation of the predecessor company [section 72A(6A)].

However, by virtue of section 72A(6B), the successor LLP can carry forward the loss of the predecessor company only to the extent of eight assessment years from the immediate succeeding assessment years in which such loss was first computed for the original predecessor company.

(v) However, if the entity fails to fulfill any of the conditions mentioned in (ii) above, the benefit of set-off of business loss/unabsorbed depreciation availed by the LLP would be deemed to be the profits and gains of the LLP chargeable to tax in the previous year in which the LLP fails to fulfill any of the conditions listed above.

(vi) The tax credit under section 115JAA for MAT paid by the company under section 115JB would not be allowed to the successor LLP [Section 115JAA(7)].

(vii) The actual cost of the block of assets in the case of the successor LLP shall be the written down value of the block of assets as in the case of the predecessor company on the date of conversion [*Explanation 2C* to section 43(6)].

(viii) The aggregate depreciation allowable to the predecessor company and successor LLP shall not exceed, in any previous year, the depreciation calculated at the prescribed rates as if the conversion had not taken place. Such depreciation shall be apportioned between the predecessor company and the successor LLP in the ratio of the number of days for which the assets were used by them [Section 32(1)(ii)].

(ix) The cost of acquisition of the capital asset for the successor LLP shall be deemed to be the cost for which the predecessor company acquired it. It would be further increased by the cost of improvement of the asset incurred by the predecessor company or the successor LLP [Section 49(1)].

(x) If the capital asset became the property of the LLP as a result of conversion of a company into an LLP, and deduction has been allowed or is allowable in respect of such asset under section 35AD, the actual cost would be taken as Nil [*Explanation 13* to section 43(1)].

However, where an asset, in respect of which deduction is claimed and allowed under section 35AD is deemed to be the income of the assessee in accordanceI with the provisions of section 35AD(7B) (on account of being used for a purpose other than specified business under section 35AD), the actual cost of the asset to the assessee shall be actual cost to assessee as reduced by the amount of depreciation allowable had the asset been used for the purpose of business, calculated at the rate in force, since the date of its acquisition [Proviso to *Explanation 13* to section 43(1)]

(xi) If a company eligible for deduction under section 35DDA in respect of expenditure incurred under Voluntary Retirement Scheme (one-fifth of such expenditure allowable over a period of five years) is converted into an LLP and such conversion satisfies the conditions laid down in section 47(xiiib), then, the LLP would be eligible for such deduction from the year in which the transfer took place.

(xii) If a shareholder of a company receives rights in a partnership firm as consideration for transfer of shares on conversion of a company into a LLP, then the cost of acquisition of the capital asset being rights of a partner referred to in section 42 of the LLP Act, 2008 shall be deemed to be the cost of acquisition to him of the shares in the predecessor company, immediately before its conversion [Section 49(2AAA)].

TAXATION OF CO-OPERATIVE SOCIETIES

(i) General provisions: The expression "co-operative society" means a society registered under the Cooperative Societies Act, 1912 or under any other law for the time being in force in any State for the registration of co-operative societies [Section 2(19)].

For taxation, it is treated as a separate assessable entity. The profits of any business of insurance carried on by a co-operative society are to be computed in accordance with the rules set out in the First Schedule to the Act. Apart from this, the computation of income in the case of a co-operative society should also be made in the same way under each head of income as in the case of any other assessee. Entrance fees received by a co-operative society from its members is taxable as its income from business irrespective of the nature of the business carried on by the society as was held in *Co-operative Central Bank vs. C.I.T. (1965) 57 ITR 579.*

A member of a co-operative society to whom a building or a part thereof is allotted or leased under a house building scheme of the society must be deemed to be the owner of that building or part thereof under section 27(iii). Accordingly, the co-operative society is not liable to pay tax in respect of the income from the house property even though it may be the real owner according to official records and the tenant may have taken the building on lease. But where the tenant is not a member of the society or where the house is allotted to him otherwise than under a house building scheme of the society, the society will be liable to tax in respect of the income of the house property.

(ii) Deduction under section 80P: Section 80P provides certain exemptions to co-operative societies. However, the exemption is not available to co-operative banks, other than primary agricultural credit societies and primary co-operative agricultural and rural development banks. *(Students may refer to the detailed discussion of this provision in Chapter 8 "Deductions from Gross Total Income".)*

(iii) Option to exercise concessional rates of tax under section 115BAD or 115BAE: Section 115BAA provides an option to an existing domestic company to pay tax at concessional rate of 22%, if it does not claim incentive/exemption and deduction as provided in said section. Section 115BAB provides that manufacturing domestic companies set up on or after 01.10.2019, which commence manufacturing or production by 31.03.2024 and do not avail of any specified incentive or deductions, may opt to pay tax at a concessional rate of 15%.

On similar lines, section 115BAD was inserted w.e.f. A.Y. 2021-22 to provide that a co-operative society resident in India has the option to pay tax at 22%, subject to fulfilment of certain conditions. Further, w.e.f. A.Y. 2024-25, section 115BAE has been inserted to provide an option to a manufacturing co-operative society set up on or after 01.04.2023, which commences manufacturing or production on or before 31.03.2024 and does not avail of any specified incentive or deductions, may opt to pay tax at a concessional rate of 15%. In both cases, surcharge would be levied @10% on such tax. However, it may be noted that deduction u/s 80P will not be available under the concessional tax regimes.

Sections 115BAE and 115BAD provides for concessional rates of tax and exemption from Alternate Minimum Tax (AMT) in respect of certain resident co-operative societies. The provisions of these two sections are tabulated hereunder -

(1)	(2)	(3)	(4)
	Particulars	**Section 115BAE**	**Section 115BAD**
1.	**Applicability**	Co-operative society resident in India engaged in manufacturing/generation of electricity	Co-operative society resident in India
2.	**Rate of tax**	15%	22%
3.	**Rate of surcharge**	10%	10%
4.	**Effective rate of tax (including surcharge & HEC)**	**17.16%** [Tax@15% (+) Surcharge@10% (+) HEC@4%]	**25.168%** [Tax@22% (+) Surcharge@10% (+) HEC@4%]
5.	**Applicability of AMT**	Not applicable	Not applicable

(1)	(2)	(3)	(4)
	Particulars	**Section 115BAE**	**Section 115BAD**
6.	**Manner of computation of tax liability**		
	Income on which concessional rate of tax is applicable	The rate of tax (i.e., **17.16%**) is applicable in respect of income derived from or incidental to manufacturing or production of an article or thing or generation of electricity. **[Read with point no.11 below, wherein the rate of 34.32% (i.e., Tax@30% + surcharge@10% + HEC@4%) would be applicable in specified circumstance]**	The rate of tax (i.e., **25.168%)** is notwithstanding anything contained in the Income-tax Act, 1961, but subject to the provisions of Chapter XII, other than section 115BAE
	Rate of tax on income covered under Chapter XII [for example, long-term capital gains chargeable to tax u/s 112 and 112A, short-term capital gains chargeable to tax u/s 111A]	Such income would be subject to tax at the rates mentioned in the said sections in Chapter XII. Surcharge@10% would be levied on tax computed on such income. HEC@4% would be levied on the income-tax plus surcharge.	Such income would be subject to tax at the rates mentioned in the said sections in Chapter XII. Surcharge@10% is leviable on tax computed on such income. HEC@4% would be levied on the income-tax plus surcharge.
	Rate of tax on other income in respect of which no specific rate of tax is provided in Chapter XII	The applicable tax rate is **25.168% (i.e., tax@22%, plus surcharge @10% plus HEC@4%),** if such income has neither been derived from nor is incidental to manufacturing or production of an article or thing or generating electricity (For example, income from house property and income from other sources). In respect of such income, **no deduction or allowance in respect of any expenditure or allowance** shall be allowed in computing such income.	The applicable tax rate is **25.168% (i.e., tax@22% plus surcharge@10% plus HEC@4%).** There is, however, **no restriction regarding claim of any deduction or allowance** permissible under the relevant provisions of the Act.

(1)	(2)	(3)		(4)
	Particulars	**Section 115BAE**		**Section 115BAD**
	Rate of tax on STCG derived from transfer of a capital asset on which no depreciation is allowable under the Act	The applicable rate of tax is **25.168% (i.e., tax@22%, plus surcharge@10% plus HEC@4%).** There is, however, no restriction regarding claiming of deduction or allowance in this regard.		The applicable rate of tax is **25.168% i.e., tax @22%, plus surcharge @10% plus cess@4%.** There is no restriction regarding claiming of deduction or allowance in this regard.
7.	**Conditions to be fulfilled for availing concessional rate of tax and exemption from AMT**			
	Conditions to be fulfilled for availing concessional rate of tax and exemption from AMT	(i)	The co-operative society should be **set-up and registered on or after 1.4.2023.**	No time limit specified. Both existing co-operative society and new co-operative society can avail benefit.
		(ii)	It should **commence manufacturing or production of an article or thing or business of generating electricity on or before 31.3.2024**	Need not be engaged in a manufacturing or a production
		(iii)	It should **not be formed by splitting up or the reconstruction of a business already in existence**	No similar condition has been prescribed
		(iv)	It does **not** use any machinery or plant previously used for any purpose **[Refer Note at the end]**	No similar condition has been prescribed
		(v)	It should **not** be engaged in any business other than the business of manufacture or production of any article or thing and research in	No similar condition has been prescribed

(1)	(2)	(3)		(4)
	Particulars	**Section 115BAE**		**Section 115BAD**
			relation to, or distribution of, such article or thing manufactured or produced by it.	
			Note – Business of manufacture or production of any article or thing shall include generation of electricity does **not** include business of – (1) Development of computer software in any form or in any media (2) Mining (3) Conversion of marble blocks or similar items into slabs (4) Bottling of gas into cylinder (5) Printing of books or production of cinematograph films (6) Any other business as may be notified by the Central Govt. in this behalf.	
8.	**Common conditions for both sections for availing the concessional rate of tax and exemption from AMT**	In case of a co-operative society opting for either section 115BAE or 115BAD, the total income should be computed-		
		(i)	without providing for deduction under any of the following sections: **Section** | **Provision** 10AA | Exemption of profits and gains derived from export of articles or things or from	

(1)	(2)	(3)			(4)
	Particulars	Section 115BAE			Section 115BAD
					services by an assessee from unit in SEZ.
			32(1)(iia)	Additional depreciation @20%, as the case may be, of actual cost of new plant and machinery acquired and installed by manufacturing undertakings.	
			33AB	Deduction@40% of profits and gains of business of growing and manufacturing tea, coffee or rubber in India, to the extent deposited with NABARD in accordance with scheme approved by the Tea/Coffee/ Rubber Board.	
			33ABA	Deduction@20% of the profits of a business of prospecting for, or extraction or production of, petroleum or natural gas or both in India, to the extent deposited with SBI in an approved scheme or deposited in Site Restoration Account.	
			35(1)(ii)/ (iia)/(iii)	Deduction for payment to any research association, company, university etc. for undertaking scientific research or social science or statistical research.	
			35(2AA)	Deduction of payment to a National Laboratory or University or IIT or approved specified person for scientific research	
			35AD	Investment-linked tax deduction for specified businesses.	
			35CCC	Deduction of expenditure incurred on notified agricultural extension project	
			80C to 80U	Deductions from gross total income under Chapter VI-A other than the provisions of section 80JJAA.	
		(ii)	without set-off of any loss carried forward or depreciation from any earlier assessment year, if such loss or depreciation is attributable to any of the		

(1)	(2)	(3)		(4)
	Particulars	Section 115BAE		Section 115BAD
			deductions listed in (i) above [Such loss and depreciation would be deemed to have been already given effect to and no further deduction for such loss shall be allowed for any subsequent year]	
		(iii)	by claiming depreciation u/s 32 determined in the prescribed manner (i.e., in respect of depreciation of any block of assets entitled to more than 40% shall be restricted to 40% on the written down value of such block of assets). However, additional depreciation u/s 32(1)(iia) cannot be claimed.	
		<u>Note</u> – **<u>Additional points relevant in the context of section 115BAD</u>**: (1) In the case of a person having a Unit in the IFSC, referred to in section 80LA(1A), which has exercised option for section 115BAD, deduction u/s 80LA would be allowed subject to fulfilment of the conditions specified in that section. (2) Since there is no time line within which option under section 115BAD can be exercised, a co-operative society having brought forward losses and depreciation on account of deductions listed in (i) above may, if it so desires, postpone exercise the option under section 115BAD to a later assessment year, after set off of the losses and depreciation so accumulated.		
9.	**Failure to satisfy conditions**	On failure to satisfy the conditions mentioned in point no. 7 and 8 above in any P.Y., the option exercised would be **<u>invalid</u>** in respect of the assessment year relevant to that previous year and subsequent assessment years; Consequently, the other provisions of the Act would apply to the person as if the option had not been exercised for the assessment year relevant to that previous year and subsequent assessment years.		On failure to satisfy the conditions mentioned in point no. 8 above in any P.Y., the option exercised would be **<u>invalid</u>** in respect of the assessment year relevant to that previous year and subsequent assessment years; Consequently, the other provisions of the Act would apply to the person as if the option had not been exercised

(1)	(2)	(3)	(4)
	Particulars	**Section 115BAE**	**Section 115BAD**
			for the assessment year relevant to that previous year and subsequent assessment years.
10.	**Availability of set-off of AMT credit brought forward from earlier years**	No brought forward AMT credit	Brought forward AMT credit cannot be set-off against income u/s 115BAD. **Note -** If a co-operative society has b/f AMT credit, it can first exhaust the AMT credit, and thereafter opt for section 115BAD in a subsequent previous year.
11.	**Adjustments for transactions with persons having close connection**	If the Assessing Officer opines that the course of business between the co-operative society and any other person having close connection therewith is so arranged that the business transacted between them produces more than the ordinary profits to the co-operative society, he is empowered to take into account the amount of profits as may be reasonably deemed to have been derived therefrom, while computing profits and gains of such co-operative society. In case the arrangement referred above involves a specified domestic transaction referred to in section 92BA, then, the amount of profits from such transaction would be determined by considering the arm's length price (ALP).	No such requirement to make any adjustment

(1)	(2)	(3)	(4)
	Particulars	Section 115BAE	Section 115BAD
		The amount, being profits in excess of the amount of the profits determined by the Assessing Officer, shall be deemed to be the income of the person. **The income-tax on the income so deemed shall be subject to tax @ 34.32% (i.e., tax @ 30% + surcharge @10% +HEC @ 4%).** **Note** – The scope of "specified domestic transaction" referred to in section 92BA has been expanded to include within its ambit, any business transacted between such persons with close connection, where one such person is a co-operative society claiming benefit under section 115BAE.	
12.	**Exercise of option by the co-operative society within the prescribed time**	The beneficial provisions of this section would apply only if option is exercised in the prescribed manner on or before the due date u/s 139(1) for furnishing **the first of the returns of income for any previous year** relevant to assessment year or any subsequent assessment year. Such option, once exercised, would apply to subsequent assessment years. Further, once the option has been exercised for any previous year, it **cannot be subsequently withdrawn** for the same or any other previous year.	The beneficial provisions of this section would apply if option is exercised in the prescribed manner on or before the due date u/s 139(1) for furnishing the return of income for any previous year relevant to assessment year or any subsequent A.Y. Such option, once exercised, would apply to subsequent assessment years. Further, once the option has been exercised for any

(1)	(2)	(3)	(4)
	Particulars	Section 115BAE	Section 115BAD
		Note – The option has to be exercised at the time of furnishing the **first of the returns of income** for any previous year. If a person fails to so exercise such option, it cannot be exercised thereafter for any subsequent previous year. ***Accordingly, co-operative societies who have already opted for concessional tax under section 115BAE will be governed by the provisions of section 115BAE and a fresh option cannot be exercised under section 115BAE from A.Y. 2025-26 onwards.***	previous year, it **cannot be subsequently withdrawn** for the same or any other previous year. **Note** – The option can be exercised even in a later year, but once exercised, cannot be withdrawn subsequently.

Note *- For the purpose of point no.7(iv) in column (3) of the above table in relation to a co-operative society exercising option under section 115BAE, any machinery or plant which was used outside India by any other person shall not be regarded as machinery or plant previously used for any purpose, if all the following conditions are fulfilled, namely:—*

(a) such machinery or plant was not, at any time previous to the date of the installation, used in India;

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

(c) no deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under the provisions of the Income-tax Act, 1961 in computing the total income of any person for any period prior to the date of installation of the machinery or plant by the person.

Further, where in the case of a person, any machinery or plant or any part thereof previously used for any purpose is put to use by the co-operative society and the total value of the machinery or plant or part so transferred does not exceed 20% of the total value of the machinery or plant used by the co-operative society, then, the condition specified that the co-operative society does not use any machinery or plant previously used for any purpose would be deemed to have been complied with.

ILLUSTRATION 10

Transfer fees are received by a cooperative housing society from its incoming and outgoing members. Are such transfer fees liable to tax in the hands of the cooperative society?

SOLUTION

The issue under consideration is whether the transfer fees received by a co-operative housing society from its incoming and outgoing members is taxable or exempt on the principle of mutuality.

On this issue, the High Court, in *Sind Co-operative Housing Society v. ITO (2009) 317 ITR 47*, observed that under the byelaws of the society, charging of transfer fees had no element of trading or commerciality. Both the incoming and outgoing members have to contribute to the common fund of the assessee. The amount paid was to be exclusively used for the benefit of the members as a class.

The High Court, therefore, held that transfer fees received by a co-operative housing society, whether from outgoing or from incoming members, is not liable to tax on account of the principle of mutuality, since the predominant activity of such co-operative society is maintenance of property of the society and there is no taint of commerciality, trade or business.

Further, section 28(iii), which provides that income derived by a trade, professional or similar association from specific services performed for its members shall be treated as business income, can have no application since the co-operative housing society is not a trade or professional association.

Applying the rationale of the above ruling, transfer fees received by a co-operative housing society from its incoming and outgoing members would not be liable to tax in the hands of the co-operative society.

TAXATION OF INDIVIDUALS/HUF/AOPs OR BOIs

(1) Default Tax Regime [Section 115BAC]

Individuals/ Hindu Undivided Family (HUF)/ Association of Persons (AoPs) other than a co-operative society / Body of Individuals (BoIs) and Artificial Juridical Persons have to pay tax at concessional rates of tax provided under section 115BAC. The tax rates given under section 115BAC are the default tax rates unless the assessee exercises an option to shift out of the said regime. However, such persons have to forego certain exemptions and deductions under this regime. Alternatively, they can exercise the option to shift out of the default tax regime and pay tax under the optional tax regime as per the regular provisions of the Act at the tax rates prescribed by the Annual Finance Act of that year.

I. Concessional tax rates under section 115BAC

Individuals/ HUF/ AoPs other than a co-operative society/ BoIs or artificial judicial persons (Assessment of Individuals/ AoPs/ HUFs are discussed later on under this chapter) other than those who exercise the option to opt out this regime under section 115BAC(6), have to pay tax in respect of their total income (other than income chargeable to tax at special rates under Chapter XII such as section 111A, 112, 112A, 115BB, 115BBJ etc.) at the following concessional rates, subject to certain conditions specified under section 115BAC(2) –

(i)	*Upto ₹ 4,00,000*	*NIL*
(ii)	*From ₹ 4,00,001 to ₹ 8,00,000*	*5%*
(iii)	*From ₹ 8,00,001 to ₹ 12,00,000*	*10%*
(iv)	*From ₹ 12,00,001 to ₹ 16,00,000*	*15%*
(v)	*From ₹ 16,00,001 to ₹ 20,00,000*	*20%*
(vi)	*From ₹ 20,00,001 to ₹ 24,00,000*	*25%*
(vii)	*Above ₹ 24,00,000*	*30%*

II. Conditions to be satisfied for availing concessional rates of tax: The following are the conditions to be satisfied for availing concessional rates of tax:

S. No.	Particulars
(1)	**Certain deductions/exemptions not allowable:** Section 115BAC(2) provides that while computing total income, the following deductions/exemptions would not be allowed:

Section	Exemption/Deduction
10(5)	Leave travel concession
10(13A)	House rent allowance
10(14)	Exemption in respect of special allowances or benefit to meet expenses relating to duties or personal expenses (other than those as may be prescribed for this purpose).
10(17)	Daily allowance or constituency allowance of MPs and MLAs
10(32)	Exemption in respect of income of minor child included in the income of parent
10AA	Tax holiday for units established in SEZ
16	(i) Entertainment allowance (ii) Professional tax
24(b)	Interest on loan in respect of self-occupied property
32(1)(iia)	Additional depreciation
33AB	Tea/Coffee/Rubber development account
33ABA	Site Restoration Fund

	35(1)(ii),(iia), (iii) or 35(2AA)	Deduction in respect of contribution to - notified approved research association/ university/college/ other institutions for scientific research [Section 35(1)(ii)] - approved Indian company for scientific research [Section 35(1)(iia)] - notified approved research association/ university/college/other institutions for research in social science or statistical research [Section 35(1)(iii)] - An approved National laboratory/ university/IIT/ specified person for scientific research undertaken under an approved programme [Section 35(2AA)]
	35AD	Investment linked tax incentives for specified businesses
	35CCC	Deduction in respect of expenditure incurred on notified agricultural project
	80C to 80U	Deductions under Chapter VI-A (other than employers contribution towards NPS under section 80CCD(2), Central Government contribution towards Agnipath Scheme under section 80CCH(2) and deduction in respect of employment of new employees under section 80JJAA).
(2)	**Certain losses not allowed to be set-off:** While computing total income, set-off of any loss - (i) carried forward or depreciation from any earlier assessment year, if such loss or depreciation is attributable to any of the deductions referred to in (1) above; or (ii) under the head house property with any other head of income; would **not be** allowed.	
(3)	**Depreciation or additional depreciation:** Depreciation u/s 32 is to be determined in the prescribed manner. Depreciation in respect of any block of assets entitled to more than 40%, would be restricted to 40% on the written down value of such block of assets. Additional depreciation u/s 32(1)(iia), however, cannot be claimed.	
(4)	**Exemption or deduction for allowances or perquisite:** While computing total income, any exemption or deduction for allowances or perquisite, by whatever name called, provided under any other law for the time being force in India would not be allowed.	
(5)	In case of a person having a unit in IFSC referred to in section 80LA(1A), whose income is chargeable to tax under section 115BAC(1A), deduction under section 80LA would be allowed subject to fulfilment of the conditions specified in that section.	

Additional points:

(i) An employee whose income is chargeable to tax under section 115BAC(1A) would be entitled for -

- In case of salary income: Standard deduction under section 16(1)(ia) upto ₹ 75,000;

- In case of income in the nature of family pension: A deduction of a sum equal to 33-1/3 per cent of such income or ₹ 25,000, whichever is lower;
- Deduction under section 80CCD(2) in respect of contribution made by any other employer: Upto 14% of salary;
- travelling allowance (i.e., allowance granted to meet the cost of travel on tour or transfer);
- daily allowance (i.e., allowance granted on tour or for the period of journey in connection with transfer, to meet the ordinary daily charges incurred by an employee on account of absence from his normal place of duty);
- conveyance allowance (i.e., allowance granted to meet the expenditure incurred on conveyance in performance of duties of an office or employment of profit, where free conveyance is not provided by the employer); and
- exemption in respect of transport allowance granted to an employee who is blind or deaf and dumb or orthopedically handicapped with disability of the lower extremities of the body to the extent of ₹ 3,200 p.m.

(ii) An individual, being an employee paying tax as per section 115BAC, would not be entitled for exemption of perquisite of free food and non-alcoholic beverages provided by an employer through paid vouchers.

(iii) Loss or depreciation referred to in (2) above would be deemed to have been already given effect to and no further deduction for such loss or depreciation shall be allowed for any subsequent year.

Where income-tax on total income of the assessee is computed under this section and there is a depreciation allowance in respect of a block of asset from an earlier assessment year attributable to additional depreciation u/s 32(1)(iia), which has not been given full effect to prior to A.Y. 2024-25 and which is not allowed to be set-off in the A.Y.2024-25 due to section 115BAC, corresponding adjustment shall be made to the WDV of such block of assets as on 1.4.2023 in the prescribed manner i.e., the WDV as on 1.4.2023 will be increased by the unabsorbed additional depreciation not allowed to be set-off.

III. Time limit for exercising the option to shift out of the default tax regime

(i) In case of an assessee having no income from business or profession: Where such individual/HUF/AoP (other than a co-operative society)/BoI or Artificial Juridical person is **not** having income from business or profession, he/it can exercise an option to shift out/opt out of the default tax regime under this section and such option has to be exercised along with the return of income to be furnished under section 139(1) for a previous year relevant to the assessment year. In effect, such individual/HUF/AoP/BoI or Artificial Juridical person can choose whether or not to exercise the option of shifting out of the default tax regime in each previous year. He may choose to pay tax under default tax regime under section 115BAC in one year and exercise the option to shift out of default tax regime in another year.

(ii) **In case of an assessee having income from business or profession:** Such individual/HUF/AoP/BoI or Artificial Juridical person having income from business or profession has an option to shift out/ opt out of the default tax regime under this section and the option has to be exercised on or before the due date specified under section 139(1) for furnishing the return of income for such previous year and once such option is exercised, it would apply to subsequent assessment years.

Such person who has exercised the above option of shifting out of the default tax regime for any previous year shall be able to withdraw such option only once and pay tax under the default tax regime under section 115BAC for a previous year other than the year in which it was exercised.

Thereafter, such person shall never be eligible to exercise option under this section, except where such person ceases to have any business income in which case, option under (i) above would be available.

AMT liability not attracted: Individual/HUF/AoP/BoI or Artificial Juridical person paying tax under default tax regime under section 115BAC is **not** liable to alternate minimum tax u/s 115JC. Such person would not be eligible to claim AMT credit also.

Note: *It may be noted that in case of Individual/HUF/AoP/BoI or Artificial Juridical person not having income from business or profession, the total income and tax liability (including provisions relating to AMT, if applicable under normal provisions) may be computed every year both in accordance with the regular provisions of the Income-tax Act, 1961 and in accordance with the provisions of section 115BAC, in order to determine which is more beneficial and accordingly such person may decide whether to pay tax under default tax regime under section 115BAC or exercise the option to shift out and pay tax under normal provisions of the Act for that year.*

(2) Taxation of Individuals

The term “individual” as such has nowhere been defined in the Income-tax Act, 1961. Section 2(31), however, states that “person” *inter alia*, includes an individual. In the commonly understood sense of the term, an individual means a human being or a single person. The person may be major, minor, married or unmarried, possessing sound or unsound mind. All the same, he is assessable as an ‘individual’ and is liable to pay tax, if the total income earned by him during any previous year exceeds the prescribed limit exempted from tax. If an individual who is liable to pay tax for any year dies before he is assessed to tax, his executor, administrator or legal representative is treated as the individual assessee for purposes of assessment of the income of the deceased person.

(i) Tax rates

Individual assessee can pay tax at concessional rates under the default tax regime under section 115BAC (discussed above). However, he has to forego certain exemptions and deductions under this regime. Alternatively, he can exercise the option to shift out of the default tax regime and pay tax under the optional tax regime as per the regular provisions of the Act at the tax rates prescribed by the Annual Finance Act of that year.

[The slab rates for A.Y. 2026-27 applicable to an Individual/HUF/AOP/BOI/ Artificial Juridical Person exercising the option of shifting out of the default tax regime are discussed in Chapter 1 in Module 1]

(ii) Assessment of a non-resident individual

The scope of deemed income taxable in the hands of a non-resident as laid down in section 5 is explained in section 9(1) which extends the liability to tax of a non-resident individual in respect of income which although not actually accruing or arising in India deemed to be so accruing or arising, assumes significance in the assessment of non-resident individual. For better understanding of the provisions of section 9, students are advised to refer to *Chapter 21 - "Non-resident Taxation in Module 4 of the Study material.*

(iii) Special concessions in the case of individuals not being citizens of India

Although basically the law of income-tax is applicable alike to both citizens and non-citizens of India, and there is no difference in the general principles for computing the total income under the Income-tax Act, 1961, however, on a consideration of the peculiar circumstances in which a foreigner might come to or live in India, certain concessions and reliefs are granted to them under section 10(6). These have been discussed in detail in *Chapter 21 –"Non-resident Taxation in Module 4 of the Study material.*

(iv) Exemptions, reliefs and concessional rates of tax available to individuals

The tax exemptions and reliefs available under the Act to individuals in respect of income chargeable to tax fall under the following categories:

(a) Income altogether excluded from the total income, and on which in consequence, no income-tax is payable [Section 10].

(b) Deductions from gross total income both in respect of income, a part of which is not chargeable to income-tax and payments made by the assessee, a part or the whole of which is deductible from the gross total income [Chapter VI-A]

However, certain exemptions and deductions are not available where an individual is paying tax as per the default regime under section 115BAC(1A).

(v) Rebate of tax and relief in certain cases

- **Income from association of persons or bodies of individuals:** If the assessee is a member of an association of persons or a body of individuals (other than a company, co-operative society or society) income-tax shall not be payable by him in respect of any portion of the amount receivable by him from the association or body on which tax has already been paid by the association or body at the maximum marginal rate or any higher rate [Section 86].

  Further, if the total income of AOP or BOI is not chargeable to income-tax, then the share of member shall be chargeable to tax as part of his total income. Thus, in such case, the share of member shall form part of his total income.

  For the purposes of this provision in the case of an association of persons which is assessable under section 67A, the members of the AOP whose shares in the income are indeterminate or unknown, will be entitled to receive equal shares in the income of the AOP and the individual share of such member will be determined accordingly.

- **Rebate of income-tax to an individual resident in India:** In order to provide tax relief to the individual tax payers, section 87A provides a rebate from the tax payable by an assessee, being an individual resident in India.

  Rebate to resident individual paying tax under default tax regime u/s 115BAC

  (i) If the total income of the resident individual is chargeable to tax under section 115BAC and the total income of such individual ***does not exceed ₹ 12,00,000***, the rebate shall be equal to the amount of income-tax payable on his total income for any assessment year or an amount of ***₹ 60,000***, whichever is less.

  The amount of rebate under section 87A shall not exceed the amount of income-tax (as computed before allowing such rebate) on the total income of the assessee with which he is chargeable for any assessment year.

  It is further provided that the rebate shall not exceed the amount of income-tax computed as per the rates provided in section 115BAC.

ILLUSTRATION 11

Mr. X aged 34 years and a resident in India, has a total income of ₹ 11,70,000, comprising his salary income and interest on bank fixed deposit. Compute his tax liability for A.Y.2026-27 under default tax regime under section 115BAC.

SOLUTION

Computation of tax liability of Mr. X for A.Y. 2026-27

Particulars	₹
Tax on total income of ₹ 11,70,000	
5% of ₹ 4,00,000 i.e., from ₹ 4,00,000 to ₹ 8,00,000]	20,000
10% of ₹ 3,70,000 i.e., from ₹ 8,00,001 to ₹ 11,70,000	37,000
	57,000
Less: Rebate u/s 87A (Lower of tax payable or ₹ 60,000)	57,000
Tax Liability	**Nil**

(ii) If the total income of the resident individual is chargeable to tax under section 115BAC and the total income of such individual ***exceeds ₹ 12,00,000*** and income-tax payable on such total income exceeds the amount by which the total income is ***in excess of ₹ 12,00,000***, the rebate would be as follows.

Step 1 – Total income (-) ₹ 12 lakhs **(A)**

Step 2 - Compute income-tax liability on total income **(B)**

Step 3 - If **B > A**, rebate under section 87A would be a **B – A.**

The amount of rebate under section 87A shall not exceed the amount of income-tax (as computed before allowing such rebate) on the total income of the assessee.

It is further provided that the rebate shall not exceed the amount of income-tax computed as per the rates provided in section 115BAC.

ILLUSTRATION 12

Ms. Pallavi aged 32 years and a resident in India, has a total income of ₹ 12,18,000, comprising his salary income and interest on bank fixed deposit. Compute her tax liability for A.Y.2026-27 under default tax regime under section 115BAC.

SOLUTION

Computation of tax liability of Ms. Pallavi for A.Y. 2026-27

Particulars	₹	
Step 1: Total Income of ₹ 12,18,000 - ₹ 12,00,000	18,000	**(A)**
Step 2: Tax on total income of ₹ 12,18,000		
Tax@15% of ₹ 18,000 + ₹ 60,000	62,700	**(B)**
Step 3: Since B > A, rebate u/s 87A would be B - A		
[₹ 62,700 - ₹ 18,000]	44,700	
	18,000	
Add: HEC@4%	720	
Tax Liability	**18,720**	

Rebate to a resident individual paying tax under optional tax regime (normal provisions of the Act)

If total income of such individual **does not exceed ₹ 5,00,000**, the rebate shall be equal to the amount of income-tax payable on his total income for any assessment year or an amount of **₹ 12,500**, whichever is less.

The amount of rebate under section 87A shall not exceed the amount of income-tax (as computed before allowing such rebate) on the total income of the assessee with which he is chargeable for any assessment year.

Rebate is, however, not available in respect of tax payable on long-term capital gains taxable u/s 112A.

- **Relief from taxation in respect of income from retirement benefit account maintained in a notified country [Section 89A]:** Where a specified person has income accrued in a specified account, such income shall be taxed in such manner and in such year as may be prescribed.

Meaning of certain terms:

Terms	Meaning
Specified account	An account maintained in a notified country by the specified person in respect of his retirement benefits and the income from such account is not taxable on accrual basis but is taxed by such country at the time of withdrawal or redemption.
Notified country	A country as notified by the Central Government. So far vide Notification No. 25/2022, dated 4.4.2022, Canada, USA and UK have been notified by the Central Government.

Specified person	A person resident in India who opened a specified account in a notified country while being non-resident in India and resident in that country.

Accordingly, the CBDT has, vide Notification No.24/2022 dated 4.4.2022 inserted Rule 21AAA providing for taxation of income from retirement benefit account maintained in a notified country.

Option to be exercised by specified person - Where a specified person has income accrued in a specified account(s) during P.Y.2021-22 or thereafter, then, at the **option of the specified person**, such income would be included in the total income of the previous year relevant to the assessment year in which income from the said specified account(s) is taxed **at the time of withdrawal or redemption**, as the case may be, in the notified country. The option has to be exercised for all the specified accounts maintained by the specified person.

Exclusions from total income of specified person - Where the option has been exercised by a specified person, the total income of the specified person for the previous year in which income is taxable would **not** include the income which:

- has already been included in the total income of such specified person in any of the earlier previous years during which such income accrued and tax thereon has been paid under the Act; or
- was not taxable in India, in the previous year during which such income accrued, on account of,
  - such specified person being a non-resident, or resident but not ordinarily resident, during that previous year; or
  - application of the DTAA, if any.

Foreign tax, if any, paid on such income would be ignored for the purposes of computation of the foreign tax credit under Rule 128.

Option once exercised cannot be withdrawn - The option has to be exercised in the prescribed form, which has to be furnished electronically under digital signature or electronic verification code on or before the due date u/s 139(1). The option once exercised for a specified account(s) in respect of a previous year in the prescribed form would apply to all subsequent previous years and cannot be subsequently withdrawn for the previous year for which the option was exercised or any previous year subsequent to that previous year (except in case where the specified person becomes a non-resident in any subsequent previous year).

Consequences when specified person becomes non-resident in a subsequent previous year - In case the specified person, after exercising option in the prescribed form for any previous year, say, P.Y.2025-26, becomes a non-resident during any subsequent previous year, say, P.Y.2028-29, (referred to as the relevant previous year) then, the option exercised above would be deemed to have never been exercised with effect from the relevant previous year, i.e., from P.Y.2028-29. The income which has accrued in the specified account(s) during the previous year, beginning with the previous year in which option was exercised (P.Y.2025-26) till the previous year immediately preceding the relevant previous year (i.e., upto P.Y.2027-28) would be taxable during the previous year immediately preceding the relevant previous year (i.e., in the P.Y.2027-28). The tax on such income has to be paid on or before the due date for furnishing the return of income for the relevant previous year (due date for P.Y. 2028-29).

(vi) Rates of Surcharge Applicable to Individuals

Higher surcharge of 25% and 37% is leviable, where the total income of individuals/ HUF/AOPs/BoIs/artificial juridical persons exceeds ₹ 2 crores and ₹ 5 crores, respectively, and the individual has exercised the option to shift out of the default regime under section 115BAC. However, the higher surcharge rates would not be applicable on tax payable on dividend income or tax payable at special rates under section 111A, 112 and 112A. **Further, where an individual is paying tax as per the default regime under section 115BAC(1A), the maximum rate of surcharge is 25% for total income exceeding ₹ 2 crores.**

[Refer to Chapter 1: Basic Concepts in Module 1 of the Study Material, containing rates of surcharge for understanding the manner of computation of surcharge on capital gains, dividend and other income components of total income]

(3) Taxation of Hindu Undivided Families

(i) Concept of HUF

A Hindu undivided family (HUF) is treated as a separate entity for the purpose of assessment under the Income-tax Act, 1961. It is included in the definition of the term “person” under section 2(31). The levy of income-tax is on “every person”. Therefore, income-tax is payable by a HUF.

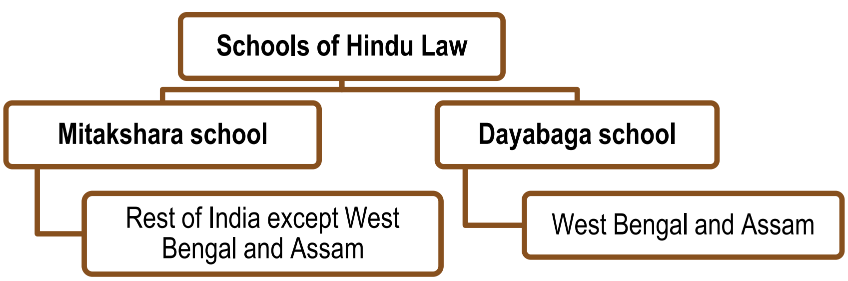
"Hindu undivided family" has not been defined under the Income-tax Act. The expression is, however, defined under the Hindu Law as a family, which consists of all males lineally descended from a common ancestor and includes their wives and daughters.

Some members of the HUF are called **co-parceners**. They are related to each other and to the head of the family. HUF may contain many members, but members within four degrees including the head of the family (Karta) are called co-parceners. A Hindu Coparcenary includes those persons who acquire an interest in joint family property by birth. Earlier, only male descendants were considered as coparceners. With effect from 6th September, 2005, daughters have also been accorded coparcenary status. It may be noted that only the coparceners have a right to demand partition.

A daughter of coparcener by birth shall become a coparcener in her own right in the same manner as the son. Being a coparcener, she can claim partition of assets of the family. The rights of a daughter in coparcenary property are equal to that of a son. However, other female members of the family, for example, wife or daughter-in-law of a coparcener are mere members of the HUF and are not eligible for such coparcenary rights.

The existence of a HUF does not arise from a contract but arises from status. There need not be more than one male member or one female coparcener w.e.f. 6th September, 2005 to form a HUF. The Income-tax Act, 1961 also does not indicate that a HUF as an assessable entity must consist of at least two male members or two coparceners.

Under the Income-tax Act, 1961, Jain undivided families and Sikh undivided families would also be assessed as a HUF.



The basic difference between the two schools of Hindu law with regard to succession is as follows:

Dayabaga school of law	Mithakshara school of law
Prevalent in West Bengal and Assam.	Prevalent in rest of India.
Nobody acquires the right, share in the property by birth as long as the head of family is living.	One acquires the right to the family property by his birth and not by succession irrespective of the fact that his elders are living.
Thus, the children do not acquire any right, share in the family property, as long as his father is alive and only on death of the father, the children will acquire right/share in the property. Hence, the father and his brothers would be the coparceners of the HUF.	Thus, every child born in the family acquires a right/ share in the family property.

(ii) Assessment of Hindu Undivided family

The income of a HUF is to be assessed in the hands of the HUF and not in the hands of any of its members. This is because HUF is a separate and a distinct tax entity.

(iii) Assessment of HUF after partition of HUF [Section 171]

There are two types of partition. They are –

(a) **Total partition –** is a partition by which the entire family property is divided amongst the coparceners. After the total partition, the HUF ceases to exist as such.

(b) **Partial partition –** is a partition which is partial as regards either the persons constituting the joint family or as regards the properties belonging to the joint family or both. In case of a partial partition as regards persons constituting the joint family, some coparceners may separate from the joint family while the others might continue to remain as part of the joint family. In case of a partial partition as regards the property, there may be a division or severance of interest in respect of some part of the estate of the joint family, while the rest of the estate may continue to remain as property of the joint family.

Effect of partial partitions made after 31st December 1978: Partial partitions after 31st December 1978 are not recognized for tax purposes. If any partial partition has been effected after 31.12.1978, then no claim of such partial partition shall be recorded by the Assessing Officer. Such family will continue to be assessed as if no such partial partition has been effected. Every member of the HUF, immediately before such partial partition, and the HUF shall be jointly and severally liable for any tax, penalty, interest, fine or other sum payable under the Act. The several liability of a member would be proportionate to the share of joint family property allotted to him on such partial partition.

When a claim of total partition of HUF has been made by any member of the HUF on behalf of the HUF, the Assessing Officer shall inquire into such claim. For this purpose, he shall give notice to all the members of the HUF. Thereafter, the Assessing Officer shall, on completion of inquiry, record a finding as to whether total partition has taken place and if so, the date when such partition was effected.

If partition has been effected in the previous year, the total income of the HUF for the previous year up to the date of partition shall be assessed as income of the HUF. Every member of the HUF, in addition to any tax for which he is separately liable, is jointly and severally liable for payment of tax on such assessed income of the HUF. The several liability of a member would be proportionate to the share of joint family property allotted to him on such partition.

If partition has been effected after expiry of previous year, the total income of the HUF for the previous year shall be assessed as income of the HUF. Every member of the HUF is jointly and severally liable for payment of tax on such assessed income of the HUF.

If partition has already taken place: If the Assessing Officer finds after completion of the assessment of a HUF that the partition has already taken place, the Assessing Officer shall proceed to recover the tax from every person who was a member of the family before the partition.

Every such member of the HUF is jointly and severally liable for payment of tax on such assessed income of the HUF.

(iv) Computation of total income of HUF

The following points should be taken into consideration while determining the total income of HUF -

(a) Income from the transfer of a self-acquired property by an individual to his HUF for inadequate consideration or conversion of the self-acquired property into property of the HUF is not considered as the income of the HUF. It would be included in the income of the individual member who transferred the property to the HUF [Section 64(2)].

(b) Section 10(2) exempts any receipt by an individual as a member of a HUF out of the family income.

(c) If a member of the HUF receives any fee or remuneration as a director or a partner in a company or firm as a consequence of the investment made in such concern out of the funds of the HUF, such fee/remuneration shall constitute income of the HUF. However, any such fee or remuneration earned by a member of a HUF as a director or partner for services rendered purely in his personal capacity, will be included in the income of the individual member and not the HUF.

(v) Tax rates

HUF can pay tax at concessional rates under the default tax regime under section 115BAC (discussed earlier). However, it has to forego certain exemptions and deductions under this regime. Alternatively, it can exercise the option to shift out of the default tax regime and pay tax under the optional tax regime as per the regular provisions of the Act at the tax rates prescribed by the Annual Finance Act of that year.

[The slab rates for A.Y. 2026-27 applicable to an Individual/HUF/AOP/BOI/ Artificial Juridical Person, exercising the option of shifting out of the default tax regime are discussed in Chapter 1 in Module 1].

(vi) Rates of surcharge applicable to HUF

Higher surcharge of 25% and 37% is leviable, where the total income of individuals/ HUF/ AOPs/BOIs/artificial juridical persons exceeds ₹ 2 crores and ₹ 5 crores, respectively and the HUF has exercised the option to shift out of the default tax regime. However, the higher surcharge would not be applicable on tax payable on dividend income and tax payable at special rates under section 111A, 112 and 112A. Further, where an HUF is paying tax as per the default regime under section 115BAC(1A), the maximum rate of surcharge is 25% for total income exceeding ₹ 2 crores. *[Refer to Chapter 1: Basic Concepts containing rates of surcharge for understanding the manner of computation of surcharge on capital gains, dividends and other income components of total income].*

(vii) Conversion of separate property into property of HUF

Generally, income from self-acquired property of an individual, who is a member of a HUF will be assessed as his personal income and not as the income of the family. However, the individual can convert his separate properties into the property of the HUF. There are no legal formalities to be complied with. These principles have been upheld by various judicial rulings.

It naturally follows that once the assets belonging to the individual are impressed with the character of joint family property, the income arising therefrom, should be assessed as the income of the HUF. However, the deeming provisions of section 64(2) specifically provide that the entire income from the converted property is taxable as the income of the transferor. This provision applies not only to property converted in the above manner but also covers transfer of property by an individual, directly or indirectly, to the family otherwise than for adequate consideration, in other words, gifts. Accordingly, where an individual makes direct or indirect gift of his separate property to the Hindu Undivided family of which he is a member or if he transfers his separate property to his family for less than its fair market value, nothing would be taxable in the hands of HUF u/s 56(2)(x) and the provisions of section 64(2) will be attracted and the entire income from such separate property converted into HUF property will be included in the total income of the individual.

(viii) Business in the personal capacity of the Karta or member

Where the Karta or any member of a joint family carries on a business on his personal capacity, the income from any such business would constitute his personal income. It does not matter even if the business of the member and of the joint family are identical in nature and size. Suppose the capital for the individual's business is borrowed from the funds of the family what will be the position? Consider the following example.

Example: *A HUF consists of the Karta, his wife, two sons and daughter. The HUF runs a departmental store. One of the two sons is qualified in business administration and the other one is an automobile engineer. Together they start a garage for repairing all types of motor cars. The technical aspects are looked after by the engineer while the general administration is taken care of by the son qualified in business administration. For starting the business, the HUF has advanced an interest-free loan of ₹ 50,000. The business is yielding good profits. Now the question arises whether the income from the business should be assessed in the hands of the Hindu undivided family.*

It is obvious that the family, in providing the interest-free loan to the business of the brothers has suffered a detriment. However, the Delhi High Court has laid down the following proposition in this connection in the case of CIT vs. Charandass Khanna & Sons (1980) 123 ITR 194 (Delhi). If investment plays a minor role and it is primarily the personal efforts, specialised skill and enterprise of the individual coparceners which resulted in the new business being set up and the profits accruing, it may not essentially be said that the income belongs to the HUF. In the present case, the good profits are more due to the specialised skills acquired by the two sons in their respective fields. Of course, the capital, got from the *family as interest free loan, has its role to play but it is nevertheless a minor one. Therefore, we can say that the income from the business set up by the brothers is assessable in their hands as individuals according to the agreed rate of sharing and not as the income of the family.*

The Supreme Court has also upheld this principle in *K.S. Subbiah Pillai vs. CIT (237 ITR 11).* It was held that remuneration received on account of personal qualification and exercise of individual exertion was assessable as individual income and not as income of HUF. The following principles have been broadly applied by the Supreme Court for determining the character of the receipt by way of remuneration paid to a coparcener:

Remuneration received on account of personal qualification and exercise of individual exertion is assessable as individual's income and not as income of HUF.

(i) when the remuneration received by the coparcener though not in form but in substance was one of the modes of return made to the family because of investment of the family funds, it has to be assessed as the income of Joint Hindu Family.

(ii) when the remuneration is not paid to the detriment of the family funds, it is assessable as the income of recipient Karta or coparcener as an individual.

(iii) when it is a compensation for the services, skill or labour of the coparcener, it has to be assessed as the income of such a coparcener in his individual capacity.

Example: *The Karta of a HUF receives salary in his capacity as a treasurer and secretary of a bank. The HUF has furnished ₹ 1,00,000 as security deposit. Decide whether the salary can be assessed as the income of the HUF.*

The position of treasurer and secretary requires considerable personal skill and integrity on the part of the incumbent. It is true that the security deposit might have been furnished by the HUF, however, since the salary is paid to the Karta primarily for the exercise of his personal skill and integrity, it is to be assessed as his individual income.

Hence, students should carefully understand the following:

(a) Where the funds of a HUF are invested in a company or a partnership firm, the dividends or share of profits are generally taxable as the income of the family. In such a case the fee, salary, commission or other remuneration received by the Karta, or any member of the family, in his capacity as director or partner would also be taxable as income of the family. The reasons for this treatment are as follows:

(1) The income is earned by the detriment to the joint family funds.

(2) It is earned with the aid of joint family funds.

(3) There is real and sufficient connection between the investment of the joint family funds and the income by way of remuneration earned.

(b) However, where the income is earned by the Karta or any other member of the family by the exercise of the personal skill, the income should be assessed in their individual hands even if some detriment is caused to the family funds, say, by way of loan, guarantee etc. whose role is only secondary.

(ix) Members of HUF in Partnership firms

A Hindu undivided family can become a partner in a firm. However, since it has no separate legal entity of its own, its Karta alone can be partner in the firm representing the family. The coparcenary has no place in the partnership.

When the Karta of Hindu undivided family enters into a partnership with strangers, the member of the family does not, *ipso facto,* become partners in that firm. They have no right to take part in its management or to sue for its dissolution. The creditors of the firm are entitled to proceed against the joint family assets including the shares of the non-partner coparceners for their debts. This is because under Hindu Law, the Karta has the right when carrying on business to pledge the credit of the joint family to the extent of its assets. The liability on the part of other members of the HUF arises by reason of their status as coparceners and not by reason of any contract of partnership by them.

Partnership between Karta representing family and Coparcener: A Karta of a HUF representing the family on the one hand, and a member of that family in his individual capacity on the other, can enter into a valid partnership. An individual coparcener, while remaining joint, can possess, enjoy and utilise in any way he likes, property which is his individual property. Therefore, when he enters into partnership with the family, he retains his share and interest in the property of the family while he simultaneously enjoys the benefit of his separate property and fruits of its investment.

(x) Salary paid to Karta for managing the family's business

If remuneration is paid to the Karta of Hindu undivided family under a valid agreement which is *bona fide* and in the interest of and expedient for the business of the family and the payment is genuine and not excessive, such remuneration would be an expenditure laid out wholly and exclusively for the purpose of the business of the family and would be allowable as an expenditure.

(xi) Salary paid to member

A Hindu undivided family can be allowed to deduct salaries paid to member of the family if the payment is made as a matter of commercial or business expediency, but the service rendered must be to the family.

(xii) Gifts to HUF

Can an outsider make a gift to HUF? Under what circumstances will a gift made by an outsider be considered as a gift to the HUF? The answers to these questions are as follows:

(a) If the HUF to which such a gift is made consists of only one coparcener, then the gifted property can be held by the members of the family only as tenants-in-common, i.e., the income arising out of such gifted property can be assessed as income in the hands of the Association of Persons (AOP).

(b) If the HUF to which such a gift is made consists of minimum two coparceners, then the gifted property can be held by the members of the family as joint tenants and the income arising out of such gifted property can be assessed as income in the hands of the joint Hindu family.

Section 56(2)(x) provides that any sum of money or value of property received by a HUF without consideration would be chargeable to income-tax under the head "Income from other sources", if the aggregate value or in case of immovable property stamp duty value of the property exceeds ₹ 50,000 during a year. However, a sum received by a HUF from its relative, i.e., a member of the HUF, is exempt. *For details, refer Chapter 5 on "Income from other sources".*

ILLUSTRATION 13

Mr. Ram (aged 56) is Karta of his HUF. The HUF consists of himself, his wife and two sons viz. Mr. C (aged 28) and Minor D (aged 16). The HUF is assessed to income tax and has business income from the year 2015-16 onwards. The business income of HUF for the year ended 31.3.2026 is ₹ 5,00,000 (computed). Mr. Ram is employed in a private company and his salary income for the same period is ₹ 6,10,000 (computed).

You are requested to answer the following treating each of them as independent situations:

(i) Mr. C gave cash gift of ₹ 1,00,000 to the HUF of Mr. Ram. What would be the total income of HUF?

(ii) *The HUF has one house property fetching rent of ₹ 10,000 per month and some movable assets. There is a proposal to make a partial partition of HUF by allotting the house property to Mr. C. Is it advisable to do a partial partition?*

(iii) *Minor D earned ₹ 70,000 by use of his special skill and talent. How would his income be taxed?*

(iv) *A car owned personally by Mr. Ram was blended with HUF during the year. It was leased out for a monthly rent of ₹ 10,000 from 1-10-2025. How would this income be taxed?*

SOLUTION

(i) Cash gift of ₹ 1 lakh by Mr. C, Ram's major son, to the HUF of Mr. Ram would not be taxable in the hands of the HUF, since gifts from a relative of the HUF does not fall within the scope of income taxable under section 56(2)(x). Since Mr. C, being Mr. Ram's son, is a member of Ram's HUF, he is a relative of the HUF. Hence, the total income of HUF would be ₹ 5 lakhs, being the business income computed.

Note *- Salary income of Mr. Ram, the Karta of the HUF, who is employed in a private company would be taxed in his individual hands, since the remuneration earned by the Karta on account of the personal qualifications and exertions and not on account of the investment of the family funds cannot be treated as income of the HUF.*

(ii) Partial partition (after 31.12.1978) is not recognized and the HUF, which has been hitherto assessed to tax, shall continue to be liable to be assessed as if no such partial partition has taken place [Section 171(9)].

The rental income in this case would continue to be assessed in the hands of the HUF, even after partial partition. Therefore, it is not advisable to do a partial partition.

(iii) Income of ₹ 70,000 earned by Minor D by use of his special skill and talent would be taxable in his individual hands. It will not be included in the hands of his parent by virtue of the exception to section 64(1A) contained in the proviso to section 64(1A).

(iv) As per section 64(2), where a member of the HUF blends his self-acquired property for inadequate consideration with the HUF, income derived therefrom is deemed to arise to the transferor-member and not to the HUF. In this case, Mr. Ram has blended his personal property (i.e., car) with the HUF.

Since there is no consideration in case of blending, the income from car computed in the prescribed manner, [which can be as per the presumptive provisions or lease rental of ₹ 60,000 (₹ 10,000 × 6 months) *less* depreciation] would be deemed as the income of Mr. Ram.

(4) Taxation of AOP/ BOI and their members

Section 2(31) defines "person" as including "association of persons" or a "body of individuals". The expression association of persons is to be understood in its ordinary sense meaning there by a group or congregation of persons. The expression association of persons is of a wider connotation and scope than that of a body of individuals. An association of persons may have as its members not only individuals (including minors) but also companies, firms, joint families and other associations. When there is a group of persons formed for the promotion of an enterprise or when co-adventures join together in a common action, they are assessable as an association of persons. Ordinarily, there can be no association of persons in business unless the members of the group join together out of their own volition or will.

In order to constitute an association of persons, the members thereof must join any common purpose or common action and the object of the association must be to produce income. Mere receipt of income by a group of members in common will not make it an association unless income is earned by its own effort in common.

The co-owners, co-legatees and joint receivers joining for a **common purpose** or action would be assessable as an association of persons. For example, if the funds of a number of beneficiaries are put together and one business is carried on with the combined resources by the trustee, guardian or administrator, the business must be regarded as a single business assessable in the hands of an association of persons. However, section 26 specifically provides an exception to the assessment of co-owners as an association of persons. According to that section, where the shares of the co-owners in respect of income from house property are defined and ascertainable, the co-owners must be assessed not as an association of persons but individually even if the property may be owned and managed and developed jointly by the co-owners.

For the purpose of assessment, it is not necessary that the association should be legally constituted. In other words, it is not necessary that there must be mutual rights and obligations amongst the members enforceable in law. The illegality, invalidity or incorrectness in the constitution of an association does not in any way affect its liability to tax or its chargeability as a unit of assessment. A partnership which is illegal or otherwise void will have to be assessed as an association of persons. The question whether there is an association of persons or not depends upon the facts and circumstances of each case.

(i) Tax Rates

An AOP/BOI can pay tax at concessional rates under the default tax regime under section 115BAC (discussed earlier). However, it has to forego certain exemptions and deductions under this regime. Alternatively, it can exercise the option to shift out of the default tax regime and pay tax under the optional tax regime as per the regular provisions of the Act at the tax rates prescribed by the Annual Finance Act of that year.

[The slab rates for A.Y. 2026-27 applicable to an Individual/HUF/AOP/BOI/ Artificial Juridical Person, exercising the option of shifting out of the default tax regime are discussed in Chapter 1 in Module 1].

(ii) Computation of total income of AOPs/BOIs

1. Computation of total income in the case of an association of persons or body of individuals will be done in the same manner as in the case of any other assessee.

2. In computing the total income, interest, salary, bonus, commission, remuneration, by whatever name called, paid to members will not be allowed [Section 40(ba)]

However, in the case of payment of interest the following provisions will apply:

Explanation 1* below section 40(ba)*: If interest is paid by an AOPs/BOIs to any member who has also paid interest to the AOPs/BOIs then only that amount of interest paid by the AOPs/BOIs will be disallowed in its assessment which is in excess of the interest paid by the member to the AOPs/BOIs i.e., net interest shall be disallowed.

Explanation 2* below section 40(ba)*: If an individual is a member of an AOPs/BOIs in a representative capacity, on behalf of or for the benefit of another person, then interest paid by the AOPs/BOIs to such individual in his personal capacity will not be taken into account for the purpose of disallowance. However, interest paid by the AOPs/BOIs to such individual or *vice-versa* as representative member or interest paid by the AOPs/BOIs directly to the beneficiary will be taken into account for the purpose of disallowance.

Explanation 3* below section 40(ba)*: If interest is paid to a member who is not a member in a representative capacity, but such interest is received by him on behalf of or for the benefit of another person the interest payment will be allowed.

♦ **Computation of tax where shares of members in AOPs/BOIs are unknown [Section 167B]**: Tax on the total income would be computed as follows:

	Circumstances	Taxability
1.	If individual share of any member is not known	Tax will be levied at the maximum marginal rate. However, if total income of any member of AOPs/BOIs is taxable at a rate higher

		than maximum marginal rate (for example, a foreign company which is a member), then total income of AOPs/BOIs shall be chargeable to tax at such higher rate of tax.
2.	If individual share of a member is known and	
	(a) total income of any member (excluding his share from AOPs/BOIs) exceeds the basic exemption limit [₹ 4,00,000 as per default regime under section 115BAC or ₹ 2,50,000/₹ 3,00,000/ ₹ 5,00,000 as per optional regime under normal provisions]	The AOPs/BOIs will pay tax at the maximum marginal rate. However, if total income of any member of AOPs/BOIs is taxable at a rate higher than maximum marginal rate (for example, a foreign company which is a member), then, total income of AOPs/BOIs shall be chargeable to tax as follows: • Portion of income attributable to such member shall be taxable at such higher rate as applicable to that member. • Balance income shall be taxable at the maximum marginal rate of tax.
	(b) no member has total income (excluding his share from AOPs/BOIs) exceeding the basic exemption limit [₹ 4,00,000 as per default regime under section 115BAC or ₹ 2,50,000/₹ 3,00,000/ ₹ 5,00,000 as per optional regime under normal provisions]	The AOPs/BOIs will pay tax as per the default regime under section 115BAC or optional regime as per normal provisions of Income-tax law applicable to an individual.

♦ **Rate of Surcharge applicable to AOP /BOI**

Higher surcharge of 25% and 37% is leviable, where the total income of AOP/BOI exceed ₹2 crores and ₹ 5 crores, respectively and they have exercised the option to shift out of the default tax regime.

Where an AOP is paying tax as per the default regime under section 115BAC(1A), the maximum rate of surcharge is 25% for total income exceeding ₹ 2 crores.

However, in respect of the following income, surcharge cannot exceed 15% both under the default regime and under the optional regime as per the normal provisions of the Act:

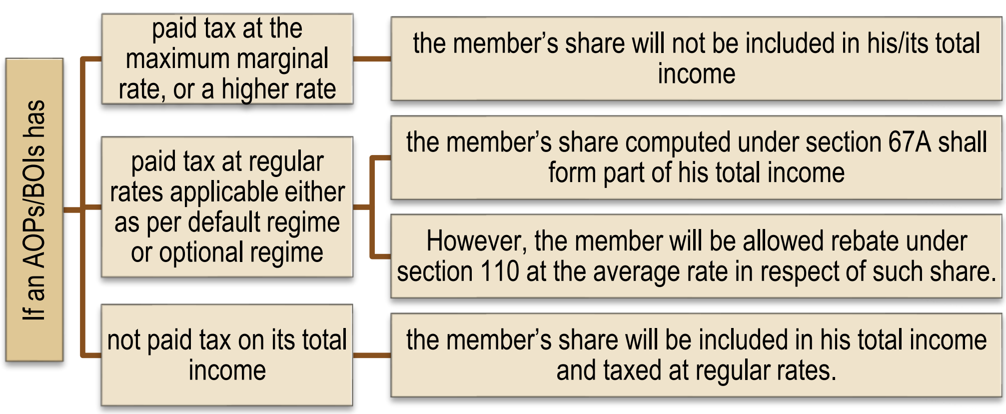
- on tax payable at special rates under section 115AD on dividend income or short-term capital gains or long-term capital gains arising from the transfer of securities referred to in 115AD(1)(b);
- on tax payable on dividend income and tax payable at special rates under section 111A, 112 and 112A;
- where the AOP consists of only company as its member.

[Refer to Chapter 1: Basic Concepts in Module 1 containing rates of surcharge for understanding the manner of computation of surcharge on capital gains, dividends and other income components of total income and also refer Chapter 21: Non-resident Taxation in Module 4 for the table containing the rates of surcharge applicable to AOPs/BOIs (having any income under section 115AD)]

♦ **Assessment of share in the hands of member [Section 86]:**

A member's share in the total income of an AOPs/BOIs will be treated as follows:

- If an AOPs/BOIs has paid tax at the maximum marginal rate, or a higher rate, the member's share in the total income of the AOPs/BOIs will not be included in his total income.
- If the AOPs/BOIs has paid tax at regular rates applicable to an individual, the member's share in the income of the AOPs/BOIs computed under section 67A shall form part of his total income. However, the member will be allowed rebate under section 110 at the average rate in respect of such share.
- If the AOPs/BOIs has not paid tax on its total income, the member's share in the total income of the AOPs/BOIs will be included in his total income and taxed at regular rates.



- **Computation of member's share in the total income of AOPs/BOIs [Section 67A]**: A member's share in the income of an AOPs/BOIs (wherein the shares of members are determinate and known) will be computed as follows:

  (a) Any interest, salary, bonus, commission, remuneration, etc. paid to a member during the previous year will be deducted from the total income of the association or body, and the balance will be apportioned among the members in proportion to their respective shares.

  (b) If the amount apportioned to a member as per (a) is a profit, any interest, salary, etc. paid to him by the association or body during the previous year will be added to that amount and the aggregate sum will be such member's share in the income of the AOPs/BOIs.

  (c) If the amount apportioned to a member as per (a) is a loss, any interest, salary, etc., paid to him by the association or body will be deducted from the amount of loss and the balance sum will be such member's share in the income of the AOPs/BOIs.

  The share of a member in the income/loss of the AOPs/BOIs will, for the purposes of assessment, be apportioned under the various heads of income in the same manner in which income/loss of the association has been determined under each head.

  Any interest paid by a member on capital borrowed by him for the purpose of investment in the AOPs/BOIs will be allowed as deduction while computing his share of income under the head "Profits and gains of business or profession."

- **Determination of tax where total income includes income on which no tax is payable [Section 110]:**

  If the total income of an assessee includes any income on which no income-tax is payable, the assessee would be entitled to a deduction, from the amount of income-tax with which he is chargeable on his total income, of an amount equal to the income-tax calculated at the average rate of income-tax on the amount on which no income-tax is payable.

- **Share of member of an AOPs/BOIs in the income of the AOPs/BOIs to be reduced from net profit for computing book profit for levy of MAT [Section 115JB]**

  (i) Under section 115JB, in the case of a company, if the tax payable on the total income computed as per the normal provisions of the Income-tax Act, 1961 is less than **15%** of its book profit, such book profit shall be deemed to be the total income of the company and the tax payable for the relevant previous year shall be **15%** of its book profit.

(ii) *Explanation 1* below section 115JB(2) provides that the expression "book profit" means profit as shown in the statement of profit and loss account prepared in accordance with the provisions of the Companies Act or in accordance with the provisions of the relevant statute governing a company, as increased or reduced by certain adjustments, as specified thereunder.

(iii) Under section 86, no income-tax is payable on the share of a member of an AOPs/BOIs in the income of the AOPs/BOIs in certain circumstances. A company which is a member of an AOPs is also not required to pay tax in respect of its share in the income of the AOPs in such cases. However, prior to A.Y.2016-17, under section 115JB, a company which is a member of an AOPs was liable to MAT on such share also, since such income was not then excluded from the book profit while computing the MAT liability of the member. It may be noted that in a similar situation, where a company is a partner in a firm, the share in the profits of the firm is exempt in the hands of the partner as per section 10(2A) and no MAT is payable by the partner on such profits, since income to which any provision of section 10 applies, has to be reduced for computing book profit.

(iv) In order to ensure equity, clause (iic) in *Explanation 1* below section 115JB(2) has been inserted with effect from A.Y. 2016-17 to provide that the share of a member of an AOPs or BOIs, in the income of the AOPs or BOIs, on which no income-tax is payable in accordance with the provisions of section 86, should be reduced while computing book profit for levy of MAT under 115JB, if any such amount is credited to statement of profit and loss account. Consequently, clause (fa) has also been inserted in *Explanation 1* to add back the expenditures, if any, debited to the statement to profit and loss, corresponding to such income, while computing book profit for levy of MAT.

ILLUSTRATION 14

JK Associates is an Association of Persons (AOP) consisting of two members, J, aged 40 years and K, aged 37 years. Shares of the members are: 60% (J) and 40% (K). Income of the AOPs for the previous year 2025-26 is ₹ 11 lakhs.

J and K's income, other than income from AOP, amount to ₹ 2.50 lakhs and ₹ 2.90 lakhs, respectively.

Compute tax liability of the AOP assuming that J exercises the option to shift out of the default regime and the AOP and its member K pays tax under default tax regime under section 115BAC(1A).

SOLUTION

Computation of tax of AOP is governed by section 167B. Tax on total income of AOP is computed as follows:

(i) If individual share of a member is known, and the total income of any member, excluding his share from such AOP, exceeds the basic exemption limit, then, the AOP will pay tax at the maximum marginal rate.

(ii) If individual share of a member is known and no member has total income (excluding his share from AOP) exceeding the basic exemption limit, then, the AOP will pay tax at the rates applicable to an individual.

Section 86 provides for assessment of share in the hands of members of AOP as follows:

A member's share in the total income of AOP will be treated as follows:-

(i) If an AOP has paid tax at the maximum marginal rate or a higher rate, the member's share in the total income of AOP will **not** be included in his total income and will be exempt.

(ii) If the AOP has paid tax at regular rates applicable to an individual, the member's share in the income of AOP will be included in his total income and he will be allowed rebate at the average rate of tax in respect of such share.

Tax Liability of J K Associates, AOP

Since none of the members have income, other than income from the AOP, exceeding the basic exemption limit, the AOP would be taxed at the rates applicable to an individual. Therefore, the AOP's tax liability would be follows:

₹ 4,00,000 – ₹ 8,00,000 @5%	₹ 20,000
₹ 8,00,001 – ₹ 11,00,000 @10%	₹ 30,000
	₹ 50,000
Add: Health & education cess @4%	2,000
Tax Liability	**52,000**

Tax Liability of J and K

Particulars	J ₹	K ₹
Share of profit from AOP	6,60,000	4,40,000
Income from other sources	2,50,000	2,90,000
Total Income (A)	**9,10,000**	**7,30,000**
Tax liability	94,500	16,500
Add: Health and Education cess @ 4%	3,780	660
Total tax (B)	**98,280**	**17,160**
Average rate of tax [B/A x 100]	10.8%	2.351%
Total tax liability	98,280	17,160
***Less*: Rebate under section 86 read with section 110 in respect of share of profit from AOP** (share in AOP x Average rate of tax)	71,280	10,344
Tax liability of members	27,000	6,816
Tax Liability (Rounded off)	**27,000**	**6,820**

TAXATION OF LOCAL AUTHORITY

(i) General meaning

The expression "local authority" has not been defined by the Income-tax Act, 1961. A local authority is a person under section 2(31) of the Income-tax Act, 1961, and thus, constitutes a separate unit of assessment. It is chargeable to tax on its total income in respect of the previous year, computed in accordance with and under the basic provisions of the Act, which apply to other taxable entities and for all purposes of the Act, this entity is included in the term 'person'. All municipal corporations, or councils, committees, panchayat boards, port trusts, district boards and other authorities legally entitled to or entrusted by the Central or State Government with the control and/or management of a municipal or local fund are covered by the expression 'local authority'.

(ii) Exemptions

Under section 10(20), the income of a local authority which is chargeable to tax under the heads 'Income from house property,' 'Capital gains' and 'Income from other sources' accruing or arising to it anywhere in or outside India and income from a trade or business carried on by it which accrues or arises to it from the supply of a commodity or service with its own jurisdiction area or from the supply of water or electricity within or outside its own jurisdictional area are totally exempt from tax.

In other words, a local authority is taxable only in respect of the income arising to it from any business carried on by it provided that such income arises from the supply of any commodity or service, not being water or electricity outside its jurisdictional area, i.e., territorial limits.

A local authority is said to be resident at the place where the control and management of its affairs are situated, and its residential status is governed by section 6(4). A local authority in India is always resident in India, except where the control and management of its affairs is exercised wholly from outside India.

(iii) Tax rate

After total income, i.e., the income of a local authority chargeable to tax has been determined, the whole of it would attract tax at the rate applicable i.e., the one prescribed by the relevant Finance Act. There is no minimum amount exempt from tax in the case of a local authority. For income tax purposes, local authority is chargeable to tax at 30% on its total income of the previous year computed in accordance with the provisions of the Act, *plus* surcharge @ 12% if its total income exceeds ₹ 1 crore *plus* health and education cess @ 4%.

TAXATION OF MUTUAL CONCERNS

(i) General principles of mutuality –

(a) The first principle of mutuality is that no person can trade with himself or make income out of himself. A mutual association arises where persons forming a group associate together with a common object and contribute monies for achieving that object and divide the surplus amongst themselves in the character. The cardinal requirement in the case of mutual association is that all the contributors to the common fund must be entitled to participate in the surplus and all the participators to the surplus must be contributors to the common fund. In other words, there must be complete identity between the contributors and the participators.

(b) The participation in the surplus need not be immediate but it may assume the shape of a reduction in the future contribution or a division of the surplus on dissolution.

(c) It does not make any difference whether the persons joining together form an association or incorporate a company because the fact of incorporation does not destroy the identity of the contributors and participators.

(d) Where there is mutuality, the fact that some members alone take advantage of the mutual enterprise would not affect the mutual character of the association.

(e) There is nothing in law which prohibits a mutual association from carrying on a trade so long as it is confined to its own members.

(f) It is not necessary that the surplus should be returned to every member of the association pro rata. The identification between the contributors and the participators should be regarded as one whole and not in relation to each individual.

(g) It is not necessary that all the activities of such an association should be mutual in character. There may be activities of a non-mutual character but the exemption from tax will apply to the surplus arising out of the mutual enterprise.

From the above principles we can conclude that one cannot trade with oneself and earn taxable profits thereby. Hence if there is a mutual concern, ordinarily there should be no tax on the profits arising out of mutual operations. But the Income-tax Act, 1961 provides for assessment of the income of a mutual concern in the following circumstances:

(1) Where the mutual concern is a mutual insurance society and the income is derived from the carrying on of any business of insurance.

(2) Where the mutual concern is a trade, professional or similar association and the income in question is derived from specific service performed for its members.

(ii) Insurance business

Under section 2(24)(vii) any surplus accruing to life as well as general mutual insurance concerns will fall within the definition of the word "income" and as such would be taxable as income from business. Section 44 expressly provides the profits and gains of any business of insurance including that carried on by a mutual insurance company or a cooperative society shall be computed not according to the provisions of the Act for computation of income under the various heads but according to the method prescribed in the Rules contained in the First Schedule to the Act. It is also provided that any expenditure which is not admissible under section 37 in computing the profits and gains of a business will be included to the profits and gains of life insurance business.

(iii) Trade and professional associations

A trade, professional or similar association may be a mutual concern. Section 28(iii) enacts that "income derived by a trade, professional or similar association from specific services performed for its members" shall be taxable as business profits. Under section 2(24)(v) any sum chargeable under section 28(iii) is deemed to be income. The object of these provisions seems to be to tax as profit the surplus arising from specific services rendered to members by a mutual trade, professional or similar association which otherwise may not be liable to tax in view of the general principles applicable to mutual concerns.

It may carefully be noted that a trade association is not the same thing as a trading association. A trade association means an association of tradesmen or businessmen for the protection or advancement of their common interests. Again clause (iii) of section 28 taxes the profit accruing only on specific services rendered by an association to its members. Any surplus arising to a mutual association in other way e.g. from entrance fees or members' periodic subscriptions would be outside the scope of this clause and would be non-taxable on the general principles stated above.

Since the surplus arising to trade, professional or similar association during the process of advancement of the common interest of the members is not includible in the taxable income it follows that the concerned expenditure will not also be allowed. Section 44A gives a benefit in this regard. It provides that in the case of such trade associations which did not distribute any parts of its income to its members, the amount of any deficit (deficiency) (excess of expenditure incurred for the advancement of the common interest of the members of the association over receipt from the members) would be deductible from the assessable income of the association to the maximum extent of 50% of such income.

This deficiency is to be deducted in the first instance from the assessable income under the head "Profits and gains of business or profession". If the deficiency exceeds such income the balance of deficiency can be set off against assessable income from any other head. The maximum limit of 50%, however, still operates. It should be noted that any adjustment of the deficiency is permissible only after effect has been given as provided in the Act to all losses, allowances etc., for the year in question or brought forward from earlier years.

(iv) Clubs

The consensus of judicial opinion is that any surplus accruing to a members' club from the subscriptions and charges for various conveniences paid by members is not income or profit at all, nor can a social club be deemed to trade as far as its dealings with its own members are concerned. The position would be the same even though the club may be incorporated as a company or registered as a society. But a club is taxable on the profit derived from subscriptions and charges paid by non-members and on the income derived from its capital assets. Where a club is an incorporated company carrying on business it may be taxable on the money received from its members as well as non-members in the course of its business.

However, if the club is not a member's club but is a proprietary club i.e. if the club is owned by an outsider and not by the members themselves, the proprietor would be taxable on the profits earned by running the club. The position would not in any way be affected by the fact that the proprietor is a limited company and some of the shareholders are members of the club.

9.3 LIABILITY OF SUCCESSOR TO BUSINESS IN RESPECT OF TAX CHARGEABLE FROM THE PREDECESSOR [SECTION 170]

(1) **Assessment of successor and predecessor:** Where a person carrying on any business or profession is succeeded by another person who continues to carry on that business or profession, both the successor and the person who is succeeded to (hereinafter called the predecessor) shall be assessed in the following manner:

- the predecessor in business would be assessable in respect of the income of the previous year in which succession took place upto the date of succession;
- the successor would be assessable in respect of the income of that previous year after the date of succession.

Accordingly, the income of the year in which the succession takes place is to be apportioned between the predecessor and the successor with the share of each. The income must be computed separately and each must be granted the deductions and allowance applicable to him. The assessment on each of these persons must be separate and distinct.

(2) **Assessment when predecessor cannot be found:** Where the predecessor cannot be found, the assessment of

- the income of the previous year in which the succession took place up to the date of succession and
- of the one year preceding the previous year of succession

should be made on the successor in like manner and to the same extent as it would have been made on the predecessor, and all the provisions of the Act shall apply accordingly.

(3) **Assessment or reassessment or other proceedings during the pendency of succession:** In case there is succession, the assessment or reassessment or any other proceedings, made or initiated on the predecessor during the course of pendency of such

succession, shall be deemed to have been made or initiated on the successor and all the provisions of this Act shall apply accordingly.

Meaning of the term "pendency": "Pendency" means the period

- commencing from the date of filing of application for such succession of business before the High Court or tribunal or the date of admission of an application for corporate insolvency resolution by National Company Law Tribunal (NCLT) and
- ending with the date on which the order of such High Court or tribunal or NCLT

is received by the Principal Commissioner or the Commissioner.

(4) **Recovery of sum payable by predecessor from the successor:** If the assessment has already been made on the predecessor for either or both of the years aforesaid, but the sum payable in pursuance of each assessment cannot be recovered from the predecessor or any person, the sum payable by the predecessor shall be payable and recoverable by the successor. Successor shall be entitled to recover the full amount of sum paid by him from the predecessor.

Under this section, the Assessing Officer is required to record a finding that the sum in respect of the income of the year of succession or the preceding year cannot be recovered from the predecessor, before seeking to recover such sum from the successor.

(5) **Predecessor income includes capital gain by virtue of succession:** The successor's liability to tax arises also in respect of any gain (e.g., capital gains) accruing to the predecessor from the transfer of the business or profession as a result of the succession. [*Explanation* to section 170].

9.4 TAX PLANNING CONSIDERATIONS IN RELATION TO BUSINESS

The scope of income liable to tax under the head "Profits and gains of business or profession" covered by sections 28 to 44D of the Income-tax Act, 1961 has been discussed earlier. The object of this part of the study material is to discuss from the angle of tax planning the various areas in which tax payer will have to take appropriate decisions to ensure that the incidence of tax in respect of his income chargeable under this head is reduced to the extent possible, by taking advantage of the various allowances, deductions and other tax concessions provided under the law.

For a new business, the spheres in which the question of tax planning is relevant are as follows:

(i) Form of the organization

(ii) Nature of the business

(iii) Financial Structure

(iv) Acquisition of plant and machinery and other fixed assets

(v) Setting up and commencement of business

Each of these aspects will be considered briefly in the following paragraphs. In addition, there is lot of scope for planning with reference to the method of accounting to be employed and the various deductions and special incentives provided under the Income-tax Act, 1961.

(1) Form of Business Organization: The choice of the appropriate form of business organization will have to be thought of and decided by the person who intends to carry on business or profession at the beginning itself, because a change in the form of business organization after the commencement of the business, may attract liability to tax.

A new business can be organized under any of the following forms:

(i) Sole proprietorship

(ii) Hindu undivided family

(iii) Association of persons or Body of Individuals

(iv) Partnership firm/LLP

(v) Company

(vi) Co-operative society

The selection of a particular form of organization would depend not only on the tax aspect but on other considerations also, e.g., financial requirements and resources, requirement of limited liability and many other practical considerations.

However, depending upon the taxable status and level of tax liability of the owners, a selection can be made from the various forms available for setting up a new unit.

- ***Sole Proprietorship:*** In the case of a sole proprietorship concern, one of the important tax disadvantages would be that no allowance or relief would be available to the tax payer in computing his income from business in respect of even a reasonable amount of remuneration attributable to the services rendered by him for carrying on the business. As a result, the taxable income arrived at would be a larger amount than what it would have been if it had been the case of, say, a firm paying remuneration to partners, such remuneration is allowable subject to the limits specified in section 40(b)(v). The taxable income from business would get reduced and correspondingly, the incidence of tax would also be reduced.

Under sole proprietorship, the entire income of a business unit gets assessed in the hands of the same person along with other income, while the entire loss and other allowances shall be available for set off in his hands against other income. This may have some advantage in the initial years, after which the possibility of converting it into company/firm may be considered; on such conversion, the questions of possible capital gains tax, etc., will have to be considered.

- ***Hindu Undivided Family:*** The Hindu undivided family as a unit of taxation continues to exist for the purpose of carrying on business as well and there is a large number of cases where business is carried on by the members of the family on behalf on the family. Since the law does not specifically provide for the disallowance of such expenses, it is advantageous to carry on a business through the HUF wherever possible. The income of the family is computed and first taxed in the hands of the family at the rates applicable to it. The income of the family may, thereafter, be divided amongst the members of the family and the members, in such cases, do not attract any liability to tax in view of the specific exemption granted under section 10(2) of the Income-tax Act, 1961. Thus, if a business is carried on by a Hindu undivided family, the advantages which are available in the case of a company could be fully availed of and in addition, the members of the family would not become liable to tax when they receive any portion of the family's income.

> Individual or HUF having income from business or profession has an option to shift out/ opt out of the default tax regime under this section and the option has to be exercised on or before the due date specified under section 139(1) for furnishing the return of income for such previous year and once such option is exercised, it would apply to subsequent assessment years.
>
> Such person who has exercised the above option of shifting out of the default tax regime for any previous year shall be able to withdraw such option only once and pay tax under the default tax regime under section 115BAC for a previous year other than the year in which it was exercised.
>
> Thereafter, such person shall never be eligible to exercise option under this section, except where such person ceases to have any business income in which case, option under (i) above would be available. *(Please refer to the detailed discussion on section 115BAC given in earlier paras of this Chapter)*

- ***Partnership Firm/LLP:*** All firms and LLPs will be taxed at a flat rate of 30%. If the total income exceeds ₹ 1 crore, surcharge @12% would be attracted. Further, health and education cess @4% would be applicable. There will be no basic exemption and the entire income will be taxed. In computing the taxable income of a firm, certain prescribed deductions in respect of interest and remuneration have to be allowed. The share income of a firm in the hands of the partners of the firm which is separately assessed as such is fully exempt under section 10(2A).

  TDS Liability on Partnership Firm: As per section 194T, partnership firm is required to deduct tax at source @10% on any sum paid to partners, such as salary, remuneration, commission, bonus, or interest. No deduction is required if the sum or aggregate of such sum does not exceed ₹ 20,000 during the financial year.

Note: An Individual, HUF or a partnership firm (but not an LLP), who is a resident carrying on eligible business can declare income on presumptive basis as per the provisions of section 44AD @8% of gross receipts or 6% in case gross receipts are received by an account payee cheque/bank draft/use of ECS through bank account/through any other electronic mode as may be prescribed on or before the due date of filing return of income].

The prescribed electronic modes are credit card, debit card, net banking, IMPS (Immediate payment Service), UPI (Unified Payment Interface), RTGS (Real Time Gross Settlement), NEFT (National Electronic Funds Transfer), and BHIM (Bharat Interface for Money) Aadhar Pay [CBDT Notification No. 8/2020 dated 29.01.2020].

An assessee, being a resident in India, carrying on notified profession can declare income on presumptive basis@50% of gross receipts as per the provisions of section 44ADA. In such a case, they need not get their books of account audited as per section 44AB.

ILLUSTRATION 15

Mr. Gavaskar sought voluntary retirement from a Government of India Undertaking and received compensation of ₹ 40 lakhs on 28th February, 2025. He is planning to use the money as capital for a business dealership in electronic goods. The manufacturer of the product requires a security deposit of ₹ 15 lakhs, which would carry interest at 8% p.a. Gavaskar's wife is a graduate and has worked as marketing manager in a multinational company for 15 years. She now looks for a change in employment. She is willing to join her husband in running the business. She expects an annual income of ₹ 5 lakhs. Mr. Gavaskar would like to draw a monthly remuneration of ₹ 40,000 and also interest @ 10% p.a. on his capital in the business. Mr. Gavaskar has approached you for a tax efficient structure of the business.

Discuss the various issues, which are required to be considered for formulating your advice. Computation of income or tax liability is not required.

SOLUTION

The selection of the form of organisation to carry on any business activity is essential in view of the differential tax rates prescribed under the Income-tax Act, 1961 and specific concessions and deductions available under the Act in respect of different entities. For the purpose of formulating advice as to the tax efficient structure of the business, it is necessary for the tax consultant to consider the following issues:

(i) In the case of sole proprietary concern, interest on capital and remuneration paid to the proprietor is not allowable as deduction under section 37(1) as the expenditure is of personal nature. On the other hand, in the case of partnership firm, both interest on capital and remuneration payable to partners are allowable under section 37(1) subject to the conditions and limits laid down in section 40(b). The partnership should be evidenced by an instrument and the individual share of partners should be specified in the instrument. Remuneration and interest should however, be authorised by the instrument of partnership and paid in accordance with such instrument. Such interest and salary shall be taxable in the hands of partners to the extent the same is allowed as deduction in the hands of the firm under section 40(b). Interest to partners can be allowed upto 12% on simple interest basis, while the limit for allowability for partners' remuneration is based on book profit under section 40(b). As per section 40(b)(v), partners' remuneration shall be allowed to the extent of aggregate of -

(a) On the first ₹ 6,00,000 of book profit or in case of loss – ₹ 3,00,000 or @90% of book profits, whichever is more

(b) On the balance of book profit – at the rate of 60%

Note

However, if the firm is eligible to declare presumptive taxation under section 44AD, 8% of gross receipts or 6% of gross receipts, as the case may be, would be deemed as its income. All deductions under section 30 to 37 are deemed to be allowed. No deduction is allowable, including deduction for partner's remuneration and interest on capital.

(ii) Partner's share in the profits of firm is not taxed in the hands of the partners by virtue of section 10(2A).

(iii) If a proprietary concern is formed, the salary of Mrs. Gavaskar shall be allowed as deduction under section 37(1).

(iv) The possibility of invoking section 40A(2) cannot be ruled out as salary is payable to a relative, who is an interested person within the meaning of section 40A(2). However, it can be argued successfully that salary of ₹ 5 lakhs is justified in view of her long experience as marketing manager of a multinational company and the fair market value of services to be rendered by her to the concern.

(v) An issue arises as to whether remuneration of Mrs. Gavaskar would be includible in the total income of Mr. Gavaskar. Under section 64(1)(ii), remuneration of the spouse of an individual working in a concern in which the individual is having a substantial interest shall be included in the total income of the individual. However, the clubbing provision does not apply if the spouse possesses technical or professional qualification and the income is solely attributable to the application of his or her technical or professional knowledge and experience. Further, technical or professional qualification would not necessarily mean the qualifications obtained by degree or diploma of any recognized body [*Batta Kalyani vs. CIT (1985) 154 ITR 0059 (AP)*]. The experience of Mrs. Gavaskar as a marketing manager in a multinational company for 15 years may reasonably be considered as a professional qualification for this purpose.

(vi) If Mrs. Gavaskar joins the proprietary concern or partnership concern of her husband as employee, remuneration of ₹ 5 lakhs shall be taxed in her hands under the head "salary". Standard deduction u/s 16(ia) of ₹ 50,000 (under optional tax regime) and ₹ 75,000 (under default tax regime) would be allowed.

(vii) If she joins as partner in the business, remuneration shall be taxed in her hand as business income under section 28 to the extent such remuneration is allowed in the hands of the firm under section 40(b).

(viii) For individuals, tax can be computed as per slab rates provided under the default regime under section 115BAC(1A). Alternatively, he can exercise the option to shift out of the default tax regime and pay tax under the optional tax regime as per the regular provisions of the Act at the tax rates prescribed by the Annual Finance Act of that year. However, where he exercises the option of shifting out of the default regime for any previous year, he would be able to withdraw such option only once.

The surcharge rate is also depended on the total income and the highest surcharge would be 37% where total income exceeds ₹ 5 crores and the assessee has opted to shift out of the default tax regime whereas under default regime highest rate of surcharge would be 25%. Health and Education cess @ 4% on income-tax plus surcharge, if applicable, is attracted in all the cases. Whereas for partnership firms' tax is levied at a flat rate of 30%. Surcharge @12% would be attracted only if total income exceeds ₹ 1 crore.

If a sole proprietary concern is formed, Mr. Gavaskar has an option to pay income-tax in respect of his total income (other than income chargeable to tax at special rates under Chapter XII) as per the default regime under section 115BAC or as per the optional regime under the normal provisions of Income-tax Act.

- ***Company:*** For any large venture requiring substantial investment and recourse to borrowed funds from banks and institutions, ordinarily the form of a limited company will have to be adopted. Within the company form of organisation, however, several alternatives exist. On the basis of the ownership and control, a company can either be organised as a widely held company, i.e. a company in which the public are substantially interested within the meaning of section 2(18) of the Income-tax Act, 1961. Alternatively, it can be organised as a closely held company. Depending upon the choice of the form of organisation of the company, the following important tax consequences would have to be considered from the view point of tax planning:

  (i) The provisions of section 79 regarding restrictions on carry forward of losses in the event of substantial change in the shareholding of the company also become applicable if the company is one in which the public are not substantially interested. This aspect would assume particular significance in the case of closely held companies where losses are made and shareholdings are transferred before such losses are fully absorbed.

  (ii) Also, MAT provisions are applicable to companies. It so happens that in case of companies enjoying tax holiday benefits still have to pay tax under MAT provisions, credit of which also cumulated for number of years without being used causing significant outflow of funds in the initial years.

  Thus, it can be seen that the concept of deemed dividend under section 2(22)(e) and the provisions of section 79 do not apply to a widely held company.

  Place of Effective Management (PoEM) framework is introduced to determine the tax payable by a foreign company that for all purposes is managed from India and yet does not pay tax domestically. Many Indian companies that have traditionally used holding companies and subsidiaries overseas for various reasons are assessing how they may be affected and are racing to put new structures in place before they come under scrutiny. These provisions provide for a foreign company to be a resident of India, if the company's place of effective management is in India. If a company's POEM is situated in India; it will be treated as Indian resident. Its global income will be taxable in India.

Rate of tax: The income-tax rate on foreign companies is higher at **35%** *plus* surcharge @*2%* (if total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore) and @ 5%, if the total income exceeds ₹ 10 crore as against 30%/25%, as the case may be (*plus* surcharge @7%, if total income exceeds ₹ 1 crore but does not exceed ₹ 10 crore and @12%, if total income exceeds ₹ 10 crore) on domestic companies.

Concessional Tax Regimes under section 115BAA and section 115BAB: Section 115BAA provides for concessional rate of tax @22% (plus surcharge@10% and HEC@4%) for domestic companies, subject to certain conditions, like non-availability of profit-linked deductions and investment-linked tax deduction under the Act, non-availability of deduction for contribution to research and development, additional depreciation etc. Domestic Companies have to exercise the option to be governed by section 115BAA. Once the company exercises such an option under section 115BAA in a year, it would continue to be governed by the special provision u/s 115BAA thereafter and cannot opt for regular provisions in any subsequent year.

Section 115BAB provides for concessional rate of tax @15% (plus surcharge@10% plus HEC@4%) to manufacturing or electricity generating domestic companies set up and registered on or after 1.10.2019, and commences manufacturing or generating electricity on or before 31.3.2024, subject to certain conditions, like non-availability of profit-linked deductions and investment-linked tax deduction under the Act, non-availability of deduction for contribution to research and development, additional depreciation etc. The option for section 115BAB could be exercised by the domestic companies in the **very first year** in which the eligible company is set up, failing which it cannot exercise such an option in the future years. Accordingly, companies who have already opted for concessional tax under section 115BAB will be governed by the provisions of section 115BAB and a fresh option cannot be exercised under section 115BAB from A.Y. 2025-26 onwards. The company who has exercised such an option under section 115BAB, it would continue to be governed by the special provisions u/s 115BAB thereafter and cannot opt for regular provisions in any subsequent year.

It may be noted that companies exercising option under section 115BAA or section 115BAB are not liable to minimum alternate tax under section 115JB.

These two sections, namely sections 115BAA and 115BAB have already discussed earlier in detail in this chapter.

ILLUSTRATION 16

ABC Ltd., a pharmaceutical company incorporated in the year 2016-17, purchased a new plant and machinery for ₹ 10 lakhs on 01-04-2025. The total income of the company for Assessment Year 2026-27 before allowing additional depreciation in respect of new plant and machinery is ₹ 20 lakhs. ABC Ltd. has not opted for the concessional tax regime under section 115BAA or 115BAA so far. Compute the tax liability of ABC Ltd. for A.Y. 2026-27 assuming its turnover for the previous year 2023-24 was ₹ 350 crores. Ignore the provisions of MAT.

SOLUTION

Computation of tax liability of ABC Ltd. for A.Y. 2026-27 under regular provisions of the Act

Particulars	₹
Total Income before allowing additional depreciation	20,00,000
Less: Additional Depreciation u/s section 32(1)(iia)[₹10 lakh x 20%]	2,00,000
Total Income	18,00,000
Applicable Tax Rate (since turnover of P.Y. 2023-24 ≤ ₹ 400 crores)	25%
	4,50,000
Add: Health & Education cess@4%	18,000
Tax Liability	**4,68,000**

Computation of tax liability of ABC Ltd. for A.Y. 2026-27 under section 115BAA

Particulars	₹
Total Income before allowing additional depreciation	20,00,000
Less: Additional Depreciation u/s section 32(1)(iia) [Not allowable as deduction while computing income u/s 115BAA]	-
Total Income	20,00,000
Applicable Tax Rate	22%
Tax payable	4,40,000
Add: Surcharge@10%	44,000
	4,84,000
Add: Health & Education cess@4%	19,360
Tax Liability	**5,03,360**

Since tax liability under the regular provisions of the Act is lower than the tax liability under the provisions of section 115BAA, it would be beneficial for ABC Ltd. not to opt for section 115BAA.

- ***Co-operatives:*** The co-operative form of business organisation, i.e., a co-operative society would also be advantageous from the tax angle and, in addition to the general benefits flowing from the co-operative form the society, can claim deduction in respect of the reasonable amount of remuneration payable to the members of the society for their services rendered, including the amount of commission, if any, payable to them and the interest on the deposits or loans given by them. The co-operative society is entitled to a further tax benefit arising from section 80P under which the income of a co-operative society is exempted from tax under different circumstances depending upon the nature of the income and/or the amount thereof. In addition to the various tax concessions which are available to all assessees, the co-operative society stands to gain substantially by virtue of the special benefits available to it under section 80P. The profits of the society remaining after payment of tax would be distributed by it amongst its members in the form of dividends subject to the relevant legislation.

  However, it may be noted that benefit under section 80P has been withdrawn in respect of all co-operative banks, other than primary agricultural credit societies (i.e. as defined in Part V of the Banking Regulation Act, 1949) and primary co-operative agricultural and rural development banks (i.e. societies having its area of operation confined to a taluk and the principal object of which is to provide for long-term credit for agricultural and rural development activities). This is for the purpose of treating co-operative banks at par with other commercial banks, which do not enjoy similar tax benefits.

  Concessional tax regimes under section 115BAD and section 115BAE: Section 115BAD provide that a co-operative society resident in India has the option to pay tax at 22%, subject to fulfilment of certain conditions. Section 115BAE provides an option to a manufacturing co-operative society set up on or after 01.04.2023, which commences manufacturing or production on or before 31.03.2024 and does not avail of any specified incentive or deductions, to opt to pay tax at a concessional rate of 15%. Co-operative societies who have already opted for concessional tax under section 115BAE will be governed by the provisions of section 115BAE and a fresh option cannot be exercised under section 115BAB from A.Y. 2025-26 onwards. In both cases, surcharge would be levied @10% on such tax.

  Sections 115BAE and 115BAD provide for concessional rates of tax and exemption from Alternate Minimum Tax (AMT) in respect of certain resident co-operative societies.

From the above analysis of various forms of the organisation and their treatment for income-tax purposes, it may be appreciated that the provisions of the taxation laws have a considerable influence on the entrepreneurs in their choice of particular form of the organisation that they should establish.

(2) **Nature of the business:** Besides the form of organisation, the choice of the nature of the business also calls for appropriate planning with reference to the various special benefits available under the taxation laws to the particular kinds of industries which are not available to other kinds. Some of these benefits are of such a substantial nature that they constitute one of the major factors in the determination of the nature of the business.

Broadly, business for this purpose may be divided into two categories - trading and manufacturing business. There could be a third category involving a combination of both. Deduction is available under section 10AA to units established in SEZ. Deduction is available to units established in Special Economic Zones during P.Y. 2020-21 where letter of approval, required to be issued in accordance with the provisions of the SEZ Act, 2005, has been issued on or before 31st March, 2020 and the manufacture or production of articles or things or providing services has begun on or before 31st March, 2021 or such other date after 31st March, 2021, as notified by the Central Government. In such case, the SEZ has deemed to have commenced manufacture or production in the P.Y.2019-20 and would be eligible for benefit of deduction under section 10AA.

A taxpayer carrying on manufacturing or industrial activities would be in a position to avail of the various concessions such as depreciation allowance, benefit of amortisation under sections 32, 35ABA, 35ABB, 35D and 35E.

Tax holiday benefit under section 80-IAC would be available in case of eligible start-up, under section 80-IBA in case of developing and building housing projects and under section 80LA in case of offshore banking unit and IFSC located in Special Economic Zone.

Section 35AD of the Act also extends investment linked tax deduction to taxpayers with respect to the capital expenditure incurred for setting up and operation of specified businesses.

While deciding the nature of the business, the benefit of tax exemption or concessional treatment available in respect of certain types of income such as agricultural income, new industrial undertakings, ships, business of repairs to ocean going vessels, business of exploration, etc. of mineral oils, etc. should also be taken into account.

(3) **Sources of Funds or Financial Structure:** Broadly speaking, the choice in the matter of financing a new unit or business would be between capital and borrowings. New units being set up by existing units or companies would have the possibility of using retained profits. In the case of a company, the means of finance are as follows:

(i) Share capital.

(ii) Debentures.

(iii) Other borrowed moneys.

(iv) Generation of funds through profits.

While the return on share capital is a charge on the profits after tax, the return on loans to the lenders is a charge on the profits before tax. Thus, recourse to borrowings would offer a tax advantage which will be reflected in a higher rate of return on the owner's capital.

(4) Acquisition of 'Fixed Assets': Apart from other considerations relevant in the context, the consequences may require a careful choice between buying or leasing some or more of the fixed assets. Assets can be bought or hired. If these are bought and are depreciable, e.g., building, plant and machinery and furniture, the assessee can claim depreciation on the cost over the years. The entire cost can be claimed as deduction against the profit. If hired, however, the charge for hire becomes an admissible deduction. Having regard to the fact that the acquisition of an asset requires a larger immediate outlay than what is necessary in the case of hiring, the company may opt for hiring in some cases rather than for straight acquisition. For example, taking the business premises on rent rather than purchasing the same may be a better proposition.

But in the case of plant and machinery, two additional considerations may arise. New plant and machinery in certain industries may enable a company to claim deduction on account of depreciation and additional depreciation which may outweigh other considerations. Similarly, if there can be a new industrial undertaking, substantial tax benefits may be available by way of tax holiday benefit, etc. but that would require employment of new plant and machinery to a large extent. These considerations may prompt an assessee to make two choices—(i) not to hire plant and machinery but to purchase them and (ii) not to purchase second hand plant and machinery but to purchase them new.

In appropriate cases, the assessee may go in for second hand imported plant and machinery, satisfying the conditions laid down. In cases where an assessee opts to go for old plant and machinery, the limit regarding the use of old plant and machinery, as laid down in Section 80-IAC should be taken into consideration. Difficulties may arise in applying the 20% limit for the value of old plant or machinery for the purpose of section 80-IA etc. since the concept of value to be adopted for this purpose has not been spelt out in the law and it is not clear whether such value should refer to the cost or market value or the written down value as per books or as per income-tax records. Particular care will have to be taken while planning for such a situation.

The assessee engaged in the specified business mentioned in section 35AD can avail the benefit of deduction of capital expenditure incurred wholly and exclusively of the purpose of such specified business. Capital expenditure incurred prior to commencement of business shall be allowed as deduction during the previous year in which the assessee commences operation of the specified business if, such expenditure incurred is capitalized in the books of accounts of the assessee on the date of commencement of its operation. However, such deduction is not available in respect of capital expenditure incurred on acquisition of any land, goodwill or financial instrument. In case the deduction under this section is claimed, no deduction shall be allowed under Chapter VI-A under "Deduction in respect of certain incomes" in relation to the specified business for the same or any other assessment year.

Interest on borrowed capital

Under clause (iii) of section 36(1), deduction of interest is allowed in respect of capital borrowed for the purposes of business or profession in the computation of income under the head "Profits and gains of business or profession". As per the proviso to section 36(1)(iii), any amount of interest paid, in respect of capital borrowed for acquisition of an asset for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction.

ICDS IX on Borrowing Costs deals with the treatment of borrowing costs. It requires borrowing costs which are directly attributable to the acquisition, construction or production of a qualifying asset to be capitalized as part of the cost of that asset.

Qualifying asset has been defined to mean –

- land, building, machinery, plant or furniture, being tangible assets;
- know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets;
- inventories that require a period of twelve months or more to bring them to a saleable condition.

This ICDS requires capitalization of specific borrowing costs (in respect of funds borrowed specifically for the purpose of acquisition, construction or production of a qualifying asset) and general borrowing costs. In case of qualifying assets being tangible and intangible assets, the capitalization shall commence from the date on which funds were borrowed and cease when such asset is first put to use.

This ICDS also provides the formula for capitalization of borrowing costs when funds are borrowed generally and used for the purpose of acquisition, construction or production of a qualifying asset. For this restricted purpose, a qualifying asset shall be such asset that necessarily require a period of 12 months or more for its acquisition, construction or production. In this case, the capitalization of borrowing costs shall commence from the date on which funds were utilized.

(5) **Setting up and commencement of production:** Setting up of business in the context of the Income-tax Act, 1961 is a concept entirely confined to that Act. It is not the same as the commencement of the business and these two concepts have been clearly distinguished for income-tax purpose. Between the date of the setting up and date of commencement, there may be an interregnum during which the assessee may be incurring expenses of a revenue nature.

Under the taxation laws, the expenditure incurred prior to the date of setting up is not normally admissible for income-tax purposes. But if those are incurred on and from the date of setting up, but before commencement of the business, they may be allowed as deduction for tax purposes provided of course they are revenue in nature and are incurred wholly and exclusively for the purposes of business.

It is now practically well settled by various judicial rulings that a business is set up as soon as it is ready to commence production and it is not necessary that actual production should be so commenced. Thus, in the case of a company established for manufacturing cement, the business is set up as soon as acquiring of limestone is commenced even if at that time the plant and machinery may not have been installed so that actual manufacturing operations may commence.

A tax planner should accordingly fix the setting up date in such a manner that the company gets the maximum scope for allowability of expenses incurred contemporaneously to the date of setting up remembering that if those are incurred prior to the setting up date those are inadmissible as direct deductions while, if such expenses are of a revenue nature and they are wholly and exclusively incurred for business purpose, and are incurred subsequent to the date of setting up, they will be admissible as normal deductions. The following examples may be noted:

(a) Such expenditure may be allowed as revenue expenditure. Expenditure by way of brokerage, legal charges, etc. for arranging long term loans, interest on borrowing— *India Cement Ltd. vs. CIT 60 ITR 52 (SC).*

(b) Such expenditure may form part of the cost of assets on which depreciation may be available – *Challapalli Sugars Ltd. vs. CIT 98 ITR 167 (SC).*

In this context, the provisions of *Explanation 8* to Section 43(1) to the effect that any interest paid or payable in connection with the acquisition of an asset, which is relatable to any period after such asset is first put to use cannot be capitalised, are relevant.

(c) Such expenditure may constitute preliminary expenditure and may be eligible for amortisation over a five year period under section 35D.

(d) Such expenditure, if being of a capital nature and if not falling under any of the three categories noted above may be disallowed and there may not be relief either on account of depreciation or amortisation.

(6) Tax planning for business deductions — Some general considerations: There are several matters which affect the assessee's ability to deduct various expenses for income-tax purposes. Some of the principal considerations to be borne in mind planning for business deductions, are given below:

Successful tax planning for business deductions pre-supposes a clear and thorough understanding of the various statutory provisions governing the deductions and an awareness of the statutory rights as well as various restrictions and conditions governing such rights. The general considerations applicable to tax planning in the field of business deductions, revolve round their-

(a) allowability.

(b) year of allowability

(c) extent of allowability (disallowing provisions if any), and

(d) carry-forward to future years.

Often, the question of expenditure being capital or revenue and the consequences attaching to the likely treatment eventually may also be an important part of the tax planning exercise. This aspect has been discussed at a later stage.

One of the important aspects of tax planning would be to see that the maximum deduction or allowance is obtained in the earliest possible time for the purpose of determination of taxable income. Therefore, while deciding about incurring of capital and revenue expenditure, the assessee should consider the tax treatment of such expenditures and the period within which the benefit of deduction or amortisation would be obtained so that he can estimate and work out cash flow position over a period of time. While tax considerations play a major role in investment decisions, the general principles of financial management and their effect on investment decisions should not be ignored.

The tax planner should keep in mind the advantage arising out of minimising the expenditure, especially in the initial years of a business, so that the profits may be maximised and the assessee may be in a position to avail of the various tax incentives like depreciation as also the tax holiday provisions.

Normally, deduction for expenditure is allowable in the year in which it is incurred or paid depending on the method of accounting followed, viz, mercantile or cash. In other words, the expenditure to be claimed as deduction should be claimed in the relevant year. Where the assessee follows the cash system of accounting, the allowance in respect of expenses would be available only when the moneys in respect of them are actually paid by the assessee. Whereas in the case of mercantile system of accounting, if a business liability has definitely arisen in the accounting year, a deduction should be allowed. Where accounts are kept on a mercantile basis, if an expenditure is claimed on the ground that it is legally deductible, it can be claimed in the year in which the liability for the expenditure is incurred even though the payment itself is made in a subsequent year. If an assessee following mercantile system fails to claim an expense in the year in which it accrues he loses the right to claim it as a deduction altogether. He cannot claim or make any attempt to reopen the accounts of the earlier year to which the expense relates.

The Supreme Court's decision in *C.I.T. vs. Gemini Cashew Sales Corporation (1967) 65 ITR 643* emphasizes the principle that if the liability to make the payment has arisen during the previous year, it must be appropriately regarded as the expenditure of that year and merely because the payment in respect of the expenditure is made in the subsequent year, the assessee would not be entitled to claim deduction in respect thereof in the subsequent year. As pointed out earlier, this is subject to the provisions of section 43B.

Normally, deduction can be claimed by the assessee only in respect of those expenses and losses which have been actually incurred by the assessee during the previous year, i.e. after the business is set up. However, there are some exceptions to this rule and a tax planner should be aware of the exceptions and make use of them in appropriate cases. For example, expenditure incurred on scientific research before the commencement of the business — capital or revenue during the three years immediately preceding the commencement of the business and coming within the scope of the *Explanation* to sections 35(1)(i) and 35(1)(ii), capital expenditure incurred prior to commencement of specified business allowed as deduction in the year of commencement of business, in case capitalized under section 35AD, preliminary expenses incurred before commencement of the business and coming within the scope of section 35D, expenditure on prospecting for minerals coming within the scope of section 35E, are cases where the assessee could claim deduction in respect of the expenditure even though the expenditure was not incurred during the previous year.

Similarly, the expenditure in respect of which deduction is claimed by the assessee should not be in the nature of capital expenditure. This is again subject to the statutory exceptions contained in provisions like section 35 and 35AD. Again, subject to the statutory exceptions, the expenditure should be incurred wholly and exclusively for the purpose of the business.

Various other expenses incurred prior to the commencement of commercial operations may, in appropriate cases, be accumulated and capitalised by being spread over the cost of various assets constructed or acquired during the pre-production period. If this is done on a proper basis, the cost of the various assets including the indirect expenses capitalised can be depreciated for tax purposes to the extent that the cost relates to assets which are themselves depreciable for income-tax purposes. This is a matter which the tax planner should bear in mind in order to ensure that expenses incurred during the construction period are properly accounted and allocated.

Specific deductions under the Income-tax Act, 1961

The Income-tax Act, 1961 lists several specific deductions. A deduction falling under each category is allowable subject to the conditions and limitations, if any which may be specified. At times the restrictive conditions apply to expenditure which is prima facie suspect as, for example, transactions with relatives or associates or within the same group coming within the scope of section 40A(2). While planning for business deductions, due regard must be had to these limitations.

In addition to the specific provisions the omnibus provision in section 37 also enables an assessee to claim deduction in respect of expenditure laid out 'wholly and exclusively for the purpose of the business' the tax planner has to take into consideration the principles emerging from the innumerable relevant judicial rulings while availing of the facility of deduction under this provision. Any expenditure incidental to business, may be deducted except those prohibited by any provision of the Act.

Ordinarily, an expenditure which is specifically provided for should be claimed under the relevant section rather under the omnibus provision. To justify the deduction under the residual clause, all that is required is that the expenditure must have been incurred wholly and exclusively and it is not necessary to prove that the expenditure was also incurred 'necessarily' or 'reasonably". The expenditure must have been incurred 'for the purpose of business'. These words are wider than the phrase "for the purpose of earning profits". A specific quid *pro quo* is not essential. It is not necessary to show that the expenditure resulted in commensurate benefit or advantage either during the same year or subsequently.

An expenditure is liable to be disallowed if it is either of a personal nature or of a capital nature. The question whether a particular expenditure is of a personal nature must be judged by reference to the assessee himself and not any other person.

Capital or Revenue: Generally speaking, an expenditure is regarded as being of a capital nature, if it results in the acquisition of an asset or of an advantage or benefit of an enduring nature.

- The test with regard to the nature of the expenditure-capital or revenue - is to be applied with reference to its purpose rather than its effect. The test must be applied by reference to the assessee himself and not any other person. For instance, a company must be obliged to construct pipelines for the purpose of its business but under conditions whereby the pipelines ultimately become the property of a municipal corporation rather than the company itself. In such a case, although the pipelines undoubtedly constitute tangible assets the expenditure may not be regarded as of a capital nature, since the assets do not belong to the company but to some other person. There are many judicial rulings to support this view. A leading case that maybe referred to in this context is *Lakshmiji Sugar Mills Co. P. Ltd. vs. CIT (1971) 82 ITR 376 (SC)].*

- If the purpose of the expenditure is to secure a commercial advantage, rather than acquisition of a capital asset, it is likely to be allowed as revenue expenditure even though the advantage may endure for an indefinite period. However, this rule is by no means inflexible or capable of universal application. Conversely, if the purpose of the expenditure is the acquisition of an advantage or benefit of an enduring nature the expenditure is liable to be treated as capital expenditure even if the period or durability of the asset acquired as the result of the expenditure is very short. For example, if a company making shoes acquires knives and lasts, whose life is only three years, the expenditure may nevertheless be regarded as capital expenditure.

- In applying the various case laws on the subject of distinction between capital and revenue, it should be recognised that circumstances do change and the law normally keeps pace with such changing circumstances. The expenditure that was regarded as capital expenditure resulting in long-term benefit during the relatively *laissez faire* days of the 19th century may not perhaps, be regarded as capital expenditure in the context of the rapid technological changes which are the feature of industrial life today. The decision of the Supreme Court in *Shahzada Nund & Sons vs. CIT 108 ITR 358* also supports this view. A tax planner would do well to keep track of the various cases reported from time to time so as to keep himself informed of the trend of judicial thinking in this regard.

In this context, the requirements spelt out in the various income computation and disclosure standards have also to be kept in mind while considering the point in time of deductibility of expenditure.

- ***Expenditure specifically allowed:*** The Income-tax Act, 1961 specifically allows many types of expenditure such as depreciation, expenditure on scientific research, expenditure on know-how, preliminary expenses, bad debts etc. The Act prescribes several conditions and restrictions for the allowance of such expenditure. The tax-planner should take care to see that all the prescribed conditions are complied with so that deductions may not be denied.

Note - A company who has opted for the special provisions under section 115BAA or 115BAB would, however, not be eligible to claim deduction on account of, *inter alia*, additional depreciation and contribution for scientific research to companies/research association/IITs.

- ***Other business expenses:*** As already explained earlier, section 37(1) deals with the various items of expenses which are otherwise not covered by the provisions of Section 30 to 36 of the Income-tax Act, 1961 and specifically provides that all expenses which are incurred wholly and exclusively (though not necessarily) for the purpose of the business or profession carried on by the assessee would be deductible in computing the assessee's business income. In order to qualify for deduction under this provision, the following important conditions will have to be fulfilled:

  (i) The expenditure should have been incurred by the assessee in the ordinary course of his business or profession;

  (ii) The expenditure should be of a revenue nature and should not be of capital nature;

  (iii) The expenditure should not be of a personal nature;

  (iv) The expenditure should not be covered by any other provisions of sections 30 to 36 for purposes of allowance and it should not also be covered by any of the provisions of disallowance contained in sections 40 to 44D; and

  (v) The expenditure should not be one which is in the nature of an appropriation of income or diversion of profits by an overriding title. It should not also be one in respect of which deduction is permissible under Chapter VI-A of the Income-tax Act, 1961 from the gross total income of the assessee.

- ***Commercial expediency:*** The concept of 'commercial expediency' helps a tax payer in insisting that a reasonable view is taken of his right to deduct normal expenditure. The trend in judicial thinking has also recognised this concept. This concept reflects the fact that it is virtually impossible for the legislation to list all possible deductions to which an assessee would be entitled in computing his taxable income and therefore the fact that a business has to be run by the assessee himself under normal commercial conditions must be recognised in determining the allowability of certain expenditure. The test of commercial expendiency should be applied from the point of view of a normal prudent businessman, by reference to modern concepts of business responsibility and not by reference to the subjective standards of the revenue department.

A claim on the ground of commercial expediency is subject to the under-noted conditions and limitations:

(a) If the expenditure is covered by one of the express provisions in the Act, it must conform to the requirements stipulated therein.

(b) An expenditure which is expressly disallowed under the Act cannot be claimed on grounds of commercial expediency.

(c) An expenditure cannot be claimed on grounds of commercial expediency if it is improper or illegal. It may be commercially expedient to pay a bribe or incur a penalty but this does not mean that the bribe or penalty would be normally deductible for tax purposes.

There is also a distinction between a payment made for a violation or breach of law and payment made for a breach of contract. Courts have taken the view that where the payments are not in the nature of penalties for infraction of any law but made in pursuance of the exercise of an option given in a particular scheme and where the assessee opts for it out of commercial expediency and business consideration, it could be allowed as deduction.

(7) **Tax planning in case of losses:** The provisions of sections 70, 71 and 72 of the Income-tax Act, 1961 regulate the manner in which losses incurred in the business carried on by any tax payer will have to be dealt with for tax purposes. The consideration to be given by tax payers in the matter of taking the full benefit of set-off of losses permissible under the law is as important as the considerations for tax planning which are taken into account in regard to business expenses or claiming the maximum allowances and deductions particularly in view of the fact that the provisions of set-off of losses offer valuable scope for planning.

Under section 73, losses incurred in speculation business are to be set off only against the income from the business of speculation, if any, which the assessee may derive in the same year or in the subsequent four years. In view of the prohibition in the matter of set-off of losses incurred in speculation business, it would be in the interest of the assessee to avoid indulging in the business of speculation if it is likely to result in losses and there is no possibility of setting it off against future speculation profits within the specified period. Where the business of speculation carried on by the assessee is not profitable, he could discontinue the business of speculation in the same line so that the quantum of losses could be reduced and the assessee could resort to speculation in any other profitable field thereby taking the benefit of exception provided under the law.

The Supreme Court, in *CIT vs. Shantilal P. Ltd. (1983) 144 ITR 57,* held that a transaction cannot be described as a 'speculative transaction' within the meaning of section 43(5), where there is a breach of a contract and on a dispute between the parties, damages are awarded as compensation by an arbitration award. However, where there is no dispute and damages on a pre-determined basis are payable under the contract, without actual delivery of the goods contracted for, the transaction would be a speculative one. If any loss arises out of such a speculative transaction, such speculation loss would not be available for adjustment against other business profits, if any.

Loss from specified business referred to in section 35AD can be carried forward indefinitely under section 73A for set-off against income from the same or any other specified business. Such loss cannot, however, be set-off against income from non-specified business or income under any other head.

The assessee should exercise his right to set off of brought forward loss at the first available opportunity. The Madras High Court, in *Tyresoles (India) vs. CIT [1963] 49 ITR 515,* held that where losses sustained are not set off against the profits of the immediately succeeding year or years, they cannot be set off against profits at a later date. This has been followed by the Punjab and Haryana High Court in *B.C.S. Kartar Chit Fund and Finance Co. (P.) Ltd. vs. CIT [1989] 79 CTR (P & H) 232.* Hence, as a matter of proper tax planning, the assessee should exercise the right under section 72 in the immediately succeeding year/years when the profits allow such a set off.

It is also significant to note that, under section 79, a closely held company will be entitled to claim the benefit of carry forward and set-off of losses, only if shares carrying at least 51% of the voting power is held on the last day of the previous year by the same persons who held such shares on the last day of the previous year in which the loss was incurred. In case of a closely held company, being an eligible start up referred to in section 80-IAC, the loss incurred in any year prior to the previous year (say, in P.Y.2021-22) can be carried forward for set-off against the income of the relevant previous year (i.e., P.Y.2025-26), if shares carrying at least 51% of the voting power is held on the last day of the previous year (i.e., as on 31.3.2026) by the same persons who held such shares on the last day of the previous year in which the loss was incurred (i.e., as on 31.3.2022). In the alternative, all shareholders of such company holding shares carrying voting power on the last day of the previous year in which the loss was incurred (i.e., as on 31.3.2022), should continue to hold those shares on the last day of the previous year in which the loss is to be set-off (i.e., as on 31.3.2026) and such loss should have been incurred during the ten years beginning from the date of incorporation of such company. This benefit will not be denied, if the change has occurred on account of death of a shareholder or on account of transfer by a shareholder to his relative by way of a gift. This benefit will also not be denied if the change in shareholding of an Indian company, which is a subsidiary of a foreign company, is the result of an amalgamation or demerger. However, this is subject to the condition that 51% shareholders of the amalgamating or demerged foreign company continue to be the shareholders of the amalgamated or resulting foreign company. Further, the benefit of carry forward and set-off would not be denied to accompany, 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.

It should be kept in mind that section 79 applies to carry forward and set off of losses and not to the benefit of deduction in respect of unabsorbed depreciation.

Loss Returns: In the context of discussion on losses it would be relevant to point out that the tax planner would do well to keep in mind the implications of the provisions of section 139(3) read with section 80.

If an assessee is to get the benefit of the determination of the loss and its carry forward under section 72(1) or 73(2) or 73A(2) or 74(1) or 74A(3), he should file a return voluntarily within the period specified in section 139(1).

However, filing of return within the period specified in section 139(1) is not necessary for carry forward of loss from house property under section 71B and unabsorbed depreciation.

Section 80AC stipulates compulsory filing of return of income on or before the due date specified under section 139(1) as a pre-condition for availing benefit of deductions under any provision of Chapter VI-A under the heading "C.-Deductions in respect of certain incomes".

9.5 OTHER PROVISIONS RELATED TO VARIOUS ENTITIES

(1) Tax on income from life insurance business

Section 115B provides for a concessional rate of tax for taxing the profits and gains derived from the business of life insurance. Under these provisions, in the case of an assessee whose total income includes any profits and gains derived from the business of life insurance computed in accordance with the First Schedule to the Income-tax Act, 1961, the income-tax payable shall be the aggregate of –

(i) the amount of income-tax calculated on the **income from life insurance business** included in total income at the rate of **12½%** and

(ii) the amount of income-tax with which the assessee would have been chargeable had the total income of the assessee been reduced by the amount of profits and gains from the life insurance business.

Income accruing or arising to a company from life insurance business referred to in section 115B would not be subject to MAT. [Section 115JB(5A)].

Taxation of income/loss of non-life insurance business: Rule 5 of the First Schedule to the Income-tax Act, 1961 provides that the profits and gains of non-life insurance business would be the profit before tax and appropriations as disclosed in the profit and loss account prepared in accordance with the provisions of the Insurance Act, 1938 or the IRDA Act, 1999, subject to following adjustment -

- expenditure or allowances not allowable under sections 30 to 43B,
- any provision for diminution in the value of investment debited to profit and loss account has to be added back,
- any gain or loss on realization of investments not credited or debited to profit and loss account, shall be added or deducted, as the case may be, and
- reserve for unexpired risk as prescribed shall be allowed.

(2) Special Rates of tax in respect of certain specified income or assets

♦ **Tax on income from GDRs purchased in foreign currency or capital gains arising from transfer of such GDRs [Section 115ACA]**

(i) **Eligible assessee [Section 115ACA(1)(a)/(b)]**-This section applies to resident individuals who are employees of an Indian company engaged in specified knowledge based industry or service, or employee of its subsidiary engaged in specified knowledge based industry or service.

(ii) **Eligible income and special rate of tax [Section 115ACA(1)(a)/(b)] -** Where the total income includes the following income namely –

(a) income by way of dividends in respect of Global Depository Receipts of an Indian company engaged in specified knowledge based industry or service, purchased by an eligible assessee in foreign currency issued in accordance with such employees' stock option scheme as the Central Government may specify in this behalf,

(b) income by way of long-term capital gains arising from the transfer of the aforesaid Global Depository Receipts,

Then, the aforesaid income will be taxed at the following rates:

- at the rate of **10%** in respect of income by way of interest or dividend referred to in (a) above; and
- at the rate of **12.5%** in respect of long-term capital gain from the transfer of above bonds or GDRs.

(iii) **No deduction is allowed [Section 115ACA(2)]-** In the case of the aforesaid resident employee, no deduction shall be allowed under any provisions of this Act, where the gross total income consists only of income by way of dividend from Global Depository Receipts.

However, where the gross total income includes dividend income or long term capital gain from such Global Depository Receipts, the deduction under any provisions of the Act shall be allowed only on that portion of gross total income which does not include such income from the Global Depository Receipts.

(iv) **No benefit of first and second proviso of section 48 [Section 115ACA(3)]-** The first and second provisos to section 48 relating to the computation of capital gains shall not apply in case of transfer of Global Depository Receipts of an Indian company purchased by the resident employee in foreign currency. In other words, no indexation will be available even if the assets are long term capital assets.

(v) **Meaning of certain terms:**

S. No.	Term	Meaning
1.	**Global Depository Receipts**	Any instrument in the form of a depository receipt or certificate (by whatever name called) created by the Overseas Depository Bank outside India or in an International Financial Services Centre and issued to investors against the issue of – (i) ordinary shares of issuing company, being a company listed on a recognized stock exchange in India; or (ii) foreign currency convertible bonds of issuing company; (iii) ordinary shares of issuing company, being a company incorporated outside India, if such depository receipt or certificate is listed and traded on any International Financial Services Centre

2.	**Specified knowledge-based industry or service**	(i) information technology software; (ii) information technology service; (iii) entertainment service; (iv) pharmaceutical industry; (v) bio-technology industry; and (vi) any other industry or service, as may be notified by the Central Government
3.	**Subsidiary**	The term includes subsidiary incorporated outside India
4.	**Information technology service**	Any service which results from the use of any information technology software over a system of information technology products for realising value addition
5.	**Overseas Depository Bank**	A bank authorised by the issuing company to re-issue Global Depository Receipts against issue of Foreign Currency Convertible Bonds or ordinary shares of the issuing company.

♦ **Concessional Taxation Regime for royalty income in respect of patent developed and registered in India [Section 115BBF]**

(i) The Finance Act, 2016 introduced a concessional taxation regime for royalty income from patents for the purpose of promoting indigenous research and development and making India a global hub for research and development.

(ii) The purpose of the concessional taxation regime is for encouraging entities to retain and commercialise existing patents and for developing new innovative patented products.

(iii) Further, this beneficial taxation regime will incentivise entities to locate the high-value jobs associated with the development, manufacture, and exploitation of patents in India.

(iv) The nexus approach has been recommended by the OECD under Action Plan 5 in Base Erosion and Profit Shifting (BEPS) project. This approach requires attribution and taxation of income arising from exploitation of Intellectual property (IP) in the jurisdiction where substantial research and development (R & D) activities are undertaken instead of the jurisdiction of legal ownership. The provisions of section 115BBF are accordingly in line with such approach.

(v) **Concessional rate of tax -** Section 115BBF provides that where the total income of the eligible assessee includes any income by way of royalty in respect of a patent developed and registered in India, then such royalty shall be **taxable at the rate of 10% (plus applicable surcharge and cess).** For this purpose, developed means at-least 75% of the expenditure should be incurred in India by the eligible assessee for any invention in respect of which patent is granted under the Patents Act, 1970.

(vi) **No expenditure is allowed -** No deduction for any expenditure or allowance in respect of such royalty income shall be allowed under the Act.

(vii) **Option of concessional rate to be exercised before due date under section 139(1) -** The eligible assessee has to exercise the option for taxation of income by way of royalty in respect of a patent developed and registered in India in accordance with the provisions of section 115BBF in the prescribed manner, on or before the due date specified under section 139(1) for furnishing the return of income for the relevant previous year.

(viii) **Not eligible to opt for concessional taxation under this section for 5 assessment years -** Where an eligible assessee opts for taxation of income by way of royalty in respect of a patent developed and registered in India for any previous year in accordance with section 115BBF, and the assessee offers the income for taxation for any of the five assessment years relevant to the previous year succeeding the previous year not in accordance with section 115BBF(1),then the assessee shall not be eligible to claim the benefit of section 115BBF for five assessment years subsequent to the assessment year relevant to the previous year in which such income has not been offered to tax in accordance with section 115BBF(1).

(ix) **Non-applicability of MAT provisions -** Further, the amount of income by way of royalty in respect of patent chargeable to tax under section 115BBF would not be subject to MAT under section 115JB. The same would be reduced while arriving at the book profit. Consequently, the related expenditure would be added back for arriving at the book profit.

(x) **Meaning of certain terms**

S. No.	Term	Meaning
1	**Eligible assessee**	Eligible assessee **means**: • A person resident in India, • who is the true and first inventor of the invention and • whose name is entered on the patent register as the patentee in accordance with Patents Act, 1970. Eligible assessee **includes:** every such person, being the true and the first inventor of the invention, where more than one person is registered as patentee under Patents Act, 1970 in respect of that patent.
2	**Royalty**	"Royalty", in respect of a patent, means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient

		chargeable under the head "Capital gains" or consideration for sale of product manufactured with the use of patented process or the patented article for commercial use) for the— (1) transfer of all or any rights (including the granting of a licence) in respect of a patent; or (2) imparting of any information concerning the working of, or the use of, a patent; or (3) use of any patent; or (4) rendering of any services in connection with the activities referred to in (1) to (3) above.
3	**Lumpsum**	"Lump sum" includes an advance payment on account of such royalties which is not returnable

(3) Tax on income from transfer of Carbon credits [Section 115BBG]

(i) Carbon credits is an incentive given to an industrial undertaking for reduction of the emission of GHGs (Green House gases).

(ii) A reduction in emissions entitles the entity to a credit in the form of a Certified Emission Reduction (CER) certificate. The CER is tradable and its holder can transfer it to an entity which needs Carbon Credits to overcome an unfavourable position on carbon credits.

(iii) To bring clarity on the issue of taxation of income from transfer of carbon credits and to encourage measures to protect the environment, section 115BBG provides that where the total income of the assessee includes any income from transfer of carbon credit, such income shall be taxed at a concessional rate of **10%** (plus applicable surcharge and cess)

(iv) **No expenditure is allowed -** No expenditure or allowance in respect of such income shall be allowed under the Act.

(v) **Meaning of "Carbon credits":** Carbon credits in respect of one unit shall mean reduction of one ton of carbon dioxide emissions or emissions of its equivalent gases which is validated by the United Nations Framework on Climate Change and which can be traded in market at its prevailing market price.

SIGNIFICANT SELECT CASES

S.No.	Case Law	
1.	***Secunderabad Club v. CIT [2023] 457 ITR 263 (SC)***	
	Issue	**Facts, Analysis and Decision**
	Does the principle of mutuality apply to interest income derived from fixed deposits made with the banks by the clubs if such banks are members of the club?	**Facts of the case:** The assessee-club deposited surplus funds as term deposits with various banks (who were the club members). It claimed interest earned on said deposits as exempt from income-tax applying the principle of mutuality. **Analysis:** The principle of mutuality works on the triple test, namely- (i) Complete identity between the contributors and participators; (ii) Action of the participators and contributors must be in furtherance of the mandate of the associations or the Clubs. The mandate of the Club is a question of fact that has to be determined from the Memorandum or Articles of Association, Rules of Membership, Rules of the Organization, etc., and must be construed broadly. (iii) There must be no scope for profiteering by the contributors from a fund made by them, which could only be expended or returned to themselves. Applying the above principles to the facts of the case, it was observed that in relation to transactions, namely, the deposit of surplus funds earned by the club, in banks which are members of the club, the principle of mutuality applies till the stage of deposit of funds and would lose its application, once the funds are deposited as fixed deposit in the banks. This is because the funds would be exposed to commercial banking operations, which means that the deposits could be used for lending to

		third parties and earning a higher interest thereon by paying a lower interest rate on the fixed deposits to the club. The bank utilising the funds of the club deposited in fixed deposit receipts for their banking business would completely rupture the "privity of mutuality", and as a result, the element of complete identity between the contributors and participators would be lost. Consequently, the first condition for the claim of mutuality is not satisfied. If the surplus fund is not applied for the common purpose of the club or towards the benefit of the members of the club directly but is invested with a third party who has the right to utilise the said funds, subject to payment of interest on it and repayment of the principal when desired by the club, then, in such an event, the club loses its control over the said funds. Furthermore, as the bank utilises the fixed deposit amounts for its banking business, the club's identity with the funds is compromised. The bank's ability to derive profits by lending the amount at a higher interest rate, while paying a lower rate of interest on the fixed deposit made by the club, further disrupts the essential identicality between contributors and participators in the mutual relationship. Conversely, when a club provides its facilities to members who contribute to its income, the principle of mutuality applies due to the identity between contributors and participants. However, where the same facilities are offered to non-members or the public to generate additional income, it transforms into a commercial transaction, and the principle of mutuality no longer applies. For the triple test to apply to the different and varied transactions of the club, it is necessary

		to lift the veil and discern the nature of each transaction: whether there is third-party intervention, which is the reason for earning the income, or it is an income generated between the members and the club, as such, i.e., only between the members of the club. When the transactions of the club are viewed in the aforesaid prism, then, in each of the transactions, whether the principle of mutuality would apply has to be discerned. **Decision:** Accordingly, the Supreme Court held that the interest income earned on fixed deposits made with the banks by the appellant club has to be treated like any other income from other sources within the meaning of section 2(24). Conversely, if any income is earned by the club through its assets and resources from persons who are not members of the club, such income would also not be covered under the principle of mutuality. It would be liable to be taxed under the provisions of the Income-tax Act.
2.	***ITO v. Venkatesh Premises Co-operative Society Ltd. (2018) 402 ITR 670 (SC)***	
	Issue	**Decision**
	Are non-occupancy charges, transfer charges, common amenity fund charges received by co-operative societies from its members exempt on the basis of the doctrine of mutuality?	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 and other charges received by a co-operative society from its members are exempt owing to application of the doctrine of mutuality.
3.	***CIT v. Govindbhai Mamaiya (2014) 367 ITR 498 (SC)***	
	Issue	**Analysis and Decision**
	Where land inherited by three brothers is compulsorily acquired by	Three brothers inherited a property consequent to demise of their father. A part of this bequeathed

	the State Government, would the resultant capital gain be assessed in the status of "Association of Persons" (AOP) or in their individual status?	land was acquired by the State Government and compensation was paid for it. In this case, the property in question came to the assessees' possession through inheritance i.e., by operation of law. It is not a case where any 'association of persons" was formed by volition of the three brothers. Further, even the income earned in the form of interest is not because of any business venture of the three assessees, but is the result of the act of the Government in compulsorily acquiring the said land. Thus, the basic test to be satisfied for making an assessment in the status of AOP is absent in this case. Hence, the income from asset inherited by the legal heirs is taxable in their individual hands and not in the status of AOP.
4.	***Joint CIT v. Rolta India Ltd. (2011) 330 ITR 470 (SC)***	
	Issue	**Analysis and Decision**
	Can interest u/s 234B and 234C be levied where a company is assessed on the basis of book profits u/s 115JB?	Section 115JB(5) provides that all other provisions of the Income-tax Act, 1961 shall apply to every assessee, being a company, mentioned in that section. Section 115JB is a self-contained code pertaining to MAT, and by virtue of sub-section (5) thereof, the liability for payment of advance tax would be attracted. Therefore, if a company defaults in payment of advance tax in respect of tax payable u/s 115JB, it would be liable to pay interest under sections 234B and 234C.
5.	***Madras Gymkhana Club v. DCIT (2010) 328 ITR 348 (Mad.)***	
	Issue	**Analysis and Decision**
	Would the interest earned on surplus funds of a club deposited with institutional members satisfy the principle of mutuality to escape taxability?	The assessee-club providing facilities like gym, library, etc., to its members earned interest from fixed deposits which it had made by investment of its surplus funds with its corporate members. Interest earned from investment of surplus funds in the form of fixed deposits with institutional members does not satisfy the

		principle of mutuality and hence cannot be claimed as exempt on this ground. The interest earned is, therefore, taxable.
6.	***Sind Co-operative Housing Society v. ITO (2009) 317 ITR 47 (Bom)***	
	Issue	**Analysis and Decision**
	Can transfer fees received by a co-operative housing society from its incoming and outgoing members be exempt on the ground of principle of mutuality?	Transfer fees received by a co-operative housing society, whether from outgoing or from incoming members, is not liable to tax on the ground of principle of mutuality since the predominant activity of such co-operative society is maintenance of property of the society and there is no taint of commerciality, trade or business. Further, section 28(iii), which provides that income derived by a trade, professional or similar association from specific services performed for its members shall be treated as business income, can have no application since the co-operative housing society is not a trade or professional association.
7.	***CIT v. Anil Hardware Store (2010) 323 ITR 368 (HP)***	
	Issue	**Analysis and Decision**
	In a case where the partnership deed does not specify the remuneration payable to each individual working partner but lays down the manner of fixing the remuneration, would the assessee-firm be entitled to deduction in respect of remuneration paid to partners?	The manner of fixing the remuneration of the partners has been specified in the partnership deed. In a given year, the partners may decide to invest certain amounts of the profits into other ventures and receive less remuneration than that which is permissible under the partnership deed, but there is nothing which debars them from claiming the maximum amount of remuneration payable in terms of the partnership deed. The method of remuneration having been laid down; the assessee-firm is entitled to deduct the remuneration paid to the partners u/s 40(b)(v)

8.	*CIT v. Trans Asian Shipping Services (P) Ltd (2016) 385 ITR 637 (SC)*	
	Issue	**Analysis and Decision**
	Can income derived by an Indian shipping company from slot charter arrangement in other ships be computed applying the special provisions under Chapter XII-G of the Income-tax Act, 1961, relating to Tonnage Tax Scheme, in spite of non-fulfillment of the condition of holding a valid certificate in respect of such ships indicating its net tonnage in force?	The requirement of producing a certificate would not apply when entire ship is not chartered and the arrangement pertains only to purchase of slots, slot charter etc. The legal fiction created by section 115VG(4) is to be given proper meaning. Accordingly, income from slot charter arrangement in other ships can be computed applying the special provisions under Chapter XII-G. ***Note:*** *As per section 115VG(4), for the purposes of Chapter XII-G, the tonnage shall mean the tonnage of a ship or inland vessel, as the case may be, indicated in the certificate referred to in section 115VX and includes the deemed tonnage computed in the prescribed manner. The manner has been prescribed in Rule 11Q of the Income-tax Rules, 1962.* *Further, the Explanation to section 115VG(4) provides that for the purposes of this sub-section, 'deemed tonnage' shall be the tonnage in respect of an arrangement of purchase of slots, slot charter and an arrangement of sharing of break-bulk vessel.* *Rules 11Q(1) provides that for the purpose of Explanation to section 115VG(4), deemed tonnage in respect of an arrangement of purchase of slots and slot charter shall be computed on the following basis:* *2.5 TEU = 1 Net Tonnage (1NT)* *Where TEU is Twenty-foot Equivalent Unit (Container of this size)*

9.	*CIT v. Metal and Chromium Plater (P) Ltd. [2019] 415 ITR 123 (Mad)*	
	Issue	**Analysis and Decision**
	Should capital gains exempt under section 54EC, which forms part of the net profit in the statement of profit and loss of the assessee-company, be taken into account for calculation of tax on book profits as per section 115JB?	Capital gains which forms part of the net profit in the statement of profit and loss of the assessee-company, in respect of which exemption under section 54EC is available while computing total income under the regular provisions of the Income-tax Act, 1961, should not be taken into account for calculation of minimum alternate tax on book profits under section 115JB. ***Note –*** *The following is an extract of Circular No.13/2001 dated 9.11.2001, issued by the CBDT at the time of insertion of section 115JB in the Income-tax Act, 1961 -* *"It may be emphasised that the new provision of section 115JB is a self-contained code. Sub-section (1) lays down the manner in which income-tax payable is to be computed. Sub-section (2) provides for computation of "book profit". Sub-section (5) specifies that save as otherwise provided in this section, all other provisions of this Act shall apply to every assessee, being a company mentioned in that section. In other words, except for substitution of tax payable under the provision and the manner of computation of book profit, all the provisions of the tax including the provision relating to charge, definitions, recoveries, payment, assessment, etc., would apply in respect of the provisions of this section."* *The CBDT Circular clarifies that except for substitution of tax payable under the provision and manner of computation of book profit, all other provisions relating to charge, definitions, recoveries, payment, assessment, etc., would apply in respect of section 115JB. Therefore, "book profit" for levy of MAT has to be computed in the manner laid down under*

		section 115JB i.e., by making the adjustments as specified in the Explanations contained therein to the net profit as per the statement of profit and loss. This implies that exemptions and deductions available under the regular provisions of the Act would not be available unless expressly provided for in the Explanations to section 115JB [For example, income exempt under section 10, 11 and 12 of the Income-tax Act, 1961 have to be deducted while computing book profit for levy of MAT, if credited to the statement of profit and loss, by virtue of specific provision in clause (ii) of Explanation 1 below section 115JB(2)]. Therefore, it appears that the intent of sub-section (5) is to make applicable other provisions like payment of advance tax, interest under sections 234B and 234C, return filing, penal and prosecution provisions under the Income-tax Act, 1961 etc. to a case where tax is computed under section 115JB. The Madras High Court has, however, in this case interpreted sub-section (5) of section 115JB to also permit adjustment for exemption under section 54EC while computing MAT, even though the same is not expressly provided for in the Explanations to section 115JB.

TEST YOUR KNOWLEDGE

Questions

1. *XYZ Ltd. is engaged in the manufacture of textile since 01-04-2009. Its Statement of Profit & Loss shows a profit of ₹ 700 lakhs after debit/credit of the following items:*

   (a) Depreciation calculated on the basis of useful life of assets as per provisions of the Companies Act, 2013 is ₹ 50 lakhs.

   (b) Employer's contribution to EPF of ₹ 2 lakhs and Employees' contribution of ₹ 2 lakhs for the month of March 2026 were remitted on 30th June, 2026.

   (c) The company appended a note to its Income Statement that industrial power tariff concession of ₹ 2.5 lakhs was received from the State Government and credited the same to Statement of P & L.

   (d) The company had provided an amount of ₹ 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 of wages and reasonable certainty of revision once in 3 years.

   (e) The company had made a provision of 10% of its debtors towards bad and doubtful debts. Total sundry debtors of the company as on 31-03-2026 was ₹ 200 lakhs.

   (f) A debtor who owed the company an amount of ₹ 40 lakhs was declared insolvent and hence, was written off by debit to Statement of Profit and loss.

   (g) Sundry creditors include an amount of ₹ 50 lakhs payable to A & Co, towards supply of raw materials, which remained unpaid due to quality issues. An agreement has been made on 31-03-2026, to settle the amount at a discount of 75% of the outstanding. The amount waived is credited to Statement of Profit and Loss.

   (h) The opening and closing stock for the year were ₹ 200 lakhs and ₹ 255 lakhs, respectively. They were overvalued by 10%.

   (i) Provision for gratuity based on actuarial valuation was ₹ 500 lakhs. Actual gratuity paid debited to gratuity provision account was ₹ 300 lakhs.

   (j) Commission of ₹ 1 lakhs paid to a recovery agent for realization of a debt. Tax has been deducted and remitted as per Chapter XVIIB of the Act.

(k) The company has purchased 500 tons of industrial paper as packing material at a price of ₹ 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 ₹ 28,000/ton.

Additional Information:

(i) There was an addition to Plant & Machinery amounting to ₹ 50 lakhs on 10-06-2025, which was used for more than 180 days during the year. Additional depreciation has not been adjusted in the books.

(ii) Normal depreciation calculated as per Income-tax Rules, 1962 is ₹ 80 lakhs.

(iii) The company had credited a sub-contractor an amount of ₹ 10 lakhs on 31-03-2025 towards repairing a machinery component. The tax so deducted was remitted on 31-12-2025.

(iv) The company has collected ₹ 7 lakhs as GST from its customers and paid the same on the due dates. However, on an appeal made, the High Court directed the Department to refund ₹ 3 lakhs to the company. The company, in turn, refunded ₹ 2 lakhs to the customers from whom the amount was collected and the balance of ₹ 1 lakh is still lying under the head "Current Liabilities".

Compute total income and tax liability for A.Y. 2026-27. Ignore MAT provisions and the provisions of section 115BAA.

***Note** - The turnover of XYZ Ltd. for the P.Y.2023-24 was ₹ 405 crore.*

2. Parik Hospitality Limited is engaged in the business of running hotels of 3-star category. The company's Statement of Profit and Loss for the previous year ended 31st March 2026 shows a profit of ₹ 152 lakhs after debiting or crediting the following items:

(a) Payment of ₹ 0.25 lakh and ₹ 0.30 lakh in cash on 3rd December 2025 and 10th December 2025, respectively, for purchase of raw corn to Mr. Raja, an agriculturist, and Mr. Khalid, a spice trader for purchase of masala used for corn products, respectively.

(b) Contribution towards employees' pension scheme notified by the Central Government under section 80CCD for a sum of ₹ 3 lakhs calculated at 12% of aggregate of basic salary and dearness allowance (forming part of retirement benefits) payable to the employees in terms of employment.

(c) *Payment of ₹ 6.50 lakhs towards transportation of various materials procured by one of its hotels to M/s. Bansal Transport, a partnership firm, without deduction of tax at source. The firm opts for presumptive taxation under section 44AE and has furnished a declaration to this effect. It also furnished its Permanent Account Number in the tender document.*

(d) *Profit of ₹ 12 lakhs on sale of a plot of land to Avimunya Limited, a domestic company, the entire shares of which are held by the assessee company. The plot was acquired by Parik Hospitality Limited on 1st June 2024.*

(e) *Contribution of ₹ 2.50 lakhs to Indian Institute of Technology with a specific direction for use of the amount for scientific research programme approved by the prescribed authority.*

(f) *Expense of ₹ 10 lakhs on foreign travel of two directors for a collaboration agreement with a foreign company for a brewery project to be set up. The negotiation did not succeed, and the project was abandoned.*

(g) *Fees of ₹ 1 lakh paid to independent directors for attending Board meeting without deduction of tax at source under section 194J.*

(h) *Depreciation charged ₹ 10 lakhs.*

(i) *₹ 10 lakhs, being the additional compensation received from the State Government pursuant to an interim order of Court in respect of land acquired by the State Government in the previous year 2023-24.*

(j) *Dividend received from a foreign company ₹ 5 lakhs in which it holds 15% of the equity share capital.*

Additional information:

(i) *As a corporate debt restructuring, the bank has converted unpaid interest of ₹ 10 lakhs upto 31st March 2025 into a new loan account repayable in five equal annual installments. The first installment of ₹ 2 lakhs was paid in March 2026 by debiting new loan account.*

(ii) *Depreciation as per Income-tax Act, 1961 ₹ 15 lakhs.*

(iii) *The company received a bill for ₹ 2 lakhs on 31st March 2026 from a supplier of vegetables for supply made in March 2026. The bill was omitted to be recorded in the books in March 2026. The bill was paid in April 2026 and the necessary entry was made in the books then.*

(iv) Dividend of ₹ 7 lakhs is distributed on 25.09.2026 to its shareholders.

Compute total income of Parik Hospitality Limited for the Assessment Year 2026-27 indicating the reason for treatment of each item assuming that the company is not eligible for deduction u/s 35AD. Ignore the provisions relating to minimum alternate tax and the provisions of section 115BAA.

3. Hyper Ltd. engaged in diversified activities, earned a profit of ₹ 14,25,000 after debit/credit of the following items to its statement of profit and loss for the year ended on 31.3.2026:

(a)	*Items debited to Statement of Profit and Loss*	*₹*
	Provision for loss of subsidiary	*85,000*
	Provision for income-tax demand	*1,05,000*
	Depreciation	*3,60,000*
	Interest on deposit credited to buyers on 31.3.2026 for advance received from them, on which tax was deducted in April 2026 and was deposited on 31.7.2026	*1,00,000*
(b)	*Items credited to Statement of Profit and Loss*	
	Long term capital gain on sale of equity shares on 5.10.2025 on which securities transaction tax was paid at the time of acquisition and sale	*3,60,000*
	Income from units of UTI (Gross)	*75,000*

The company provides the following additional information:

(i) Depreciation includes ₹ 1,50,000 on account of revaluation of fixed assets.

(ii) Depreciation allowable as per Income-tax Rules is ₹ 2,80,000.

(iii) Brought forward Business Loss/Unabsorbed Depreciation:

F.Y.	Amount as per books		Amount as per Income-tax	
	Loss ₹	Depreciation ₹	Loss ₹	Depreciation ₹
2022-23	2,50,000	3,00,000	2,00,000	2,50,000
2023-24	Nil	2,70,000	1,00,000	1,80,000
2024-25	3,50,000	3,15,000	1,20,000	2,10,000

You are required to:

(i) compute the total income of the company for the assessment year 2026-27 giving the reasons for treatment of items and

(ii) examine the applicability of section 115JB of the Income-tax Act, 1961, and compute book profit and the tax credit to be carried forward.

Assume the tax rate applicable to Hyper Ltd for the P.Y. 2025-26 is 30%. Ignore the provisions of section 115BAA.

4. *The profit as per the Statement of profit and loss of XYZ Ltd., an Indian company, for the year ended 31.3.2026 is ₹ 190 lakhs arrived at after making the following adjustments:*

	Particulars	**₹ (in lakhs)**
(i)	Depreciation on assets	100
(ii)	Reserve for currency exchange fluctuation	50
(iii)	Provision for tax	40
(iv)	Proposed dividend	120

Following further information are also provided by company:

(a) Provision for tax includes ₹ 2 lakhs of interest payable on income-tax.

(b) Depreciation includes ₹ 40 lakhs towards revaluation of assets.

(c) Amount of ₹ 50 lakhs credited to statement of P & L was drawn from revaluation reserve.

(d) Balance of statement of profit and loss shown in balance sheet at the asset side as at 31.3.2025 was ₹ 30 lakhs which includes unabsorbed depreciation of ₹ 10 lakhs.

Compute the book profit under section 115JB for the year ended 31.3.2026.

5. *Mr. Harish, aged 66, running business as a proprietor furnishes the particulars of his income for the year ended 31.03.2026 as under:*

(a) Net Profit of ₹ 3,65,500 from the wholesale business of textiles and fabrics arrived at after charge of following expenses in the Profit & Loss Account:

(i) Personal travelling expenses of ₹ 12,750.

(ii) Purchase of furniture for shop on 13.6.2025 of ₹ 25,000 but charged in shop expenses.

(b) *He owns a house with two floors constructed with the financial assistance of HDFC, out of which ground floor is used by him for self-use and first floor was let out on rent for ₹ 8,500 p.m. from April 2025. The municipal tax paid for the whole house was of ₹ 2,500 and interest paid on housing loan for the construction was ₹ 52,000. Both the floors of the house are identical.*

(c) *He deposited insurance premium on the life of self of ₹ 12,500, wife ₹ 13,500, son and daughter of ₹ 28,000, repaid housing loan of ₹ 50,000 and paid ₹ 55,000 by credit card for health insurance of himself and his family.*

Compute the total income and the amount of tax liability of Mr. Harsh on such income for the Assessment Year 2026-27 assuming that he has exercised the option to shift out of the default tax regime under section 115BAC.

6. *PQR LLP, a limited liability partnership set up a unit in Special Economic Zone (SEZ) in the financial year 2019-20 for production of washing machines. The unit fulfills all the conditions of section 10AA of the Income-tax Act, 1961. During the financial year 2024-25, it has also set up a warehousing facility in a district of Tamil Nadu for storage of agricultural produce. It fulfills all the conditions of section 35AD. Capital expenditure in respect of warehouse amounted to ₹ 75 lakhs (including cost of land ₹ 10 lakhs). The warehouse became operational with effect from 1st April 2025 and the expenditure of ₹ 75 lakhs was capitalized in the books on that date.*

Relevant details for the financial year 2025-26 are as follows:

Particulars	₹
Profit of unit located in SEZ	40,00,000
Export sales of above unit received in India in convertible foreign exchange on or before 30.9.2026	80,00,000
Domestic sales of above unit	20,00,000
Profit from operation of warehousing facility (before considering deduction under Section 35AD).	1,05,00,000

Compute income tax (including AMT under Section 115JC) liability of PQR LLP for Assessment Year 2026-27.

7. *Victory Polyfibres, a partnership firm, has earned a gross total income of ₹ 300 lakhs for the year ended 31-3-2026. The firm has not undertaken any international transaction or specified domestic transaction during the said year.*

The above income includes a profit of ₹ 220 lakhs from an undertaking having a turnover of ₹ 80 crores. This is the fifth year and deduction under section 80-IA is available to the extent of ₹ 200 lakhs.

There are some grey areas in the taxation workings and hence, the assessee is contemplating to file the return of income on 7-12-2026, after seeking clarifications from tax experts.

Advise the assessee-firm by working out the total income and tax payable, where the return is filed on 31-10-2026 or when the same is filed on 7-12-2026.

What is the practical solution as regards obtaining clarifications, which might or might not have an impact on the total income? You may ignore interest under section 234A, 234B, 234C and 234F while making the computation in support of your advice.

8. *T and Q are individuals, aged 28 years and 30 years respectively, who constitute an Association of Persons, sharing profit and losses in the ratio of 2:1. For the accounting year ended 31st March 2026, the Profit and Loss account of the business is as under:*

			Figures are in ₹ '000s
Cost of goods sold	4,250	Sales	4,900
Remuneration to:		Dividend from Indian companies	25
T	130	Long term capital gains (computed)	640
Q	170		
Employees	256		
Interest to:			
T	48.3		
Q	35.7		
Other expenses	111.7		
GST penalty due	39		
Net profit	524.3		
	5,565		**5,565**

Additional information furnished:

(i) *Other expenses included:*

(a) *wrist watches costing ₹ 2,500 each were given to 12 dealers, who had exceeded the sales quota prescribed under a sales promotion scheme;*

(b) *employer's contribution of ₹ 6,000 to the Provident Fund for the month of November, 2025 was paid on 14th January 2026.*

(c) ₹ 30,000 was paid in cash to an advertising agency for publicity.

(ii) Outstanding GST penalty was paid on 15th October 2026. The penalty was imposed for non-filing of returns and statements by the due dates.

T and Q had, for this year, income from other sources of ₹ 3,60,000 and ₹ 2,32,000 respectively.

Required to:

(i) Compute the total income of the AOPs for the assessment year 2026-27; and

(ii) Discuss the tax implication for that year in the hands of the individual members.

9. *The assessee, Pandey Co-operative Housing Society, is a registered co-operative housing society, formed with the objective of maintaining the property owned by it, to effect repairs and maintenance of the common property of the members, and to confer to the members, the usual rights and privileges. For the assessment year 2026-27, the assessee has received ₹ 3 lakhs as transfer fees from the transferor members and like amount from the transferees, who at the time of transfer, were not members of the society. Discuss the eligibility to tax the aforesaid receipts in the hands of the assessee.*

10. *M/s. Beta & Co., a partnership firm in India, is engaged in development of software and providing IT enabled services through two units, one of which is located in a notified Special Economic Zone (SEZ) in Noida (commenced operations from 01.04.2013) and the other located in a domestic tariff area (DTA). The particulars relating to previous year 2025-26 furnished by the assessee are as follows:*

Total Turnover: SEZ unit ₹ 210 lakhs; DTA unit ₹ 90 lakhs

Export Turnover: SEZ unit ₹ 150 lakhs received in India in convertible foreign exchange on or before 30.9.2025; DTA unit ₹ 50 lakhs

Profit: SEZ unit ₹ 50 lakhs; DTA unit ₹ 40 lakhs.

Amount debited to Statement of Profit and Loss and credited to Special Economic Zone Re-Investment Reserve Account ₹ 20 lakhs.

Considering that the firm has no other income during the year, compute the tax liability of the firm for the A.Y. 2026-27 by integrating, analysing and applying the relevant provisions of income-tax law.

11. *Lambda Ltd. is engaged in the manufacture of fabrics since 01-04-2013. Its Statement of Profit and Loss for the previous year ended 31st March, 2026 shows a profit of ₹ 750 lakhs after debiting or crediting the following items:*

(a) *Depreciation charged on the basis of useful life of assets as per Companies Act is ₹ 52 lakhs.*

(b) *Industrial power tariff concession of ₹ 4.80 lakhs, received from Maharashtra State Government was credited to Statement of profit and loss.*

(c) *The company had provided ₹ 18 lakhs, being sum fairly estimated as payable with reasonable certainty, to workers on agreement to be entered with the workers union towards periodical wage revision once in every three years.*

(d) *Dividend received from a US company ₹ 12 lakhs.*

(e) *Loss ₹ 17 lakhs, due to destruction of a machine worth ₹ 24 lakhs by fire due to short circuit and ₹ 3 lakh received as scrap value. The insurance company did not admit the claim of the company on charge of gross negligence.*

(f) *Provision for gratuity based on actuarial valuation was ₹ 320 lakhs. Actual gratuity paid debited to gratuity provision account was ₹ 160 lakhs.*

(g) *Advertisement charges ₹ 2.30 lakhs, paid by cheque for advertisement published in the souvenir of a political party registered with the Election Commission of India.*

(h) *Long term capital gain ₹ 3 lakhs on sale of equity shares on 12.4.2025 on which Securities Transaction Tax (STT) was paid at the time of acquisition and sale.*

Additional Information:

(i) *Normal depreciation computed as per Income-tax Rules is ₹ 71 lakhs (after giving effect to the scrap value).*

(ii) *GST ₹ 8 lakhs collected from its customers was paid by the company on the due dates. On an appeal, the High Court directed the GST department to refund ₹ 3 lakhs to the company. The company in turn refunded ₹ 2 lakhs to the customers from whom it was collected and the balance ₹ 1 lakh is still lying under the head "Current Liabilities".*

Compute the total income of Lambda Ltd. for the A.Y. 2026-27 by analyzing and applying the relevant provisions of income-tax law. Briefly explain the reasons for treatment of each *item. Ignore the provisions relating to Minimum Alternate Tax. Assume that the company has not opted for section 115BAA.*

12. *X, Y and HUF of Z (represented by Z) are partners with equal shares in profits and losses of a firm, M/s Popular Cine Vision, which is engaged in the production of TV serials and telefilms.*

The earlier partnership deed did not authorise payment of remuneration or interest to partners. The partnership deed was revised by the partners on 1st June 2025 to authorise payment of remuneration of ₹ 1 lakh per month to each working partner and simple interest at 15% per annum on partners' capital. X, Y and Z are actively associated with the affairs of the firm.

The Profit & Loss Account of the firm for the year ended 31st March 2026 shows a net profit of ₹ 10 lakhs after debiting/crediting the following:

(a) *Interest amounting to ₹ 5 lakhs each was paid to partners on the balances standing to their capital accounts from 1st June, 2025 to 31st March 2026.*

(b) *Remuneration to the partners including partner in representative capacity ₹ 30 lakhs.*

(c) *Interest amounting to ₹ 2 lakhs paid to Z on loan provided by him in his individual capacity at 16% interest.*

(d) *Royalty of ₹ 5 lakhs paid to partner X, who is a professional script writer, for use of his scripts as per agreement between the firm and X. The same is authorized by partnership deed.*

(e) *Two separate payments of ₹ 18,000 and ₹ 15,000 made in cash on 1st February, 2026 to Altaf, a hairdresser, against his bill for services rendered in January, 2026 and two payments of ₹ 19,000 and ₹ 10,000 made in cash on 1st February and 2nd February, 2026, respectively, to Priyam, an assistant cameraman, against her bill for services provided in January, 2026.*

(f) *Amount of ₹ 5 lakhs provided in the books on 31st March 2026 as liability for remuneration to Shreya, a film artist and a non-resident. Tax deducted at source under section 195 from the amount so credited was paid on 3rd June 2026.*

(g) *Amount of ₹ 6 lakhs provided as gratuity for the year on the basis of actuarial valuation. Gratuity actually paid to one retired employee during the year is ₹ 1.50 lakhs.*

(h) *Interest of ₹ 1.20 lakhs received on income-tax refund under section 244(1A) in respect of A.Y. 2025-26.*

Compute the total income of the firm for the assessment year 2026-27 stating the reasons for treatment of each item.

13. *The following are the particulars relating to two Indian companies, namely, Alpha Ltd. and Beta Ltd., which are subject to tax audit u/s 44AB, for A.Y.2026-27 –*

Particulars	Alpha Ltd.	Beta Ltd.
Date of setting up/ registration	1.4.2020	1.3.2024
Main object	Manufacture of steel	Manufacture of leather
Place	Vaishali, Bihar	Ranipet, Tamil Nadu
Turnover of P.Y. 2023-24	₹ 251 crores	-
Turnover of P.Y. 2024-25	₹ 401 crores	-
Turnover of P.Y. 2025-26	₹ 270 crores	₹ 120 crores
Value of new plant and machinery installed and put to use on 1.11.2025	₹ 8 crore	₹ 5 crore
Gross Total Income of P.Y.2025-26	₹ 5 crore	₹ 5 crore
No. of new employees employed on the date of setting up/registration of the company	50	750
No. of new employees employed as on 1.4.2023	750	-
Monthly emoluments to 750 employees employed in the respective companies as mentioned above, by ECS through bank account:		
250 employees	₹ 20,000 per employee	₹ 21,000 per employee
250 employees	₹ 25,000 per employee	₹ 25,000 per employee
250 employees	₹ 28,000 per employee	₹ 27,000 per employee

From the above details -

(i) *Compute the tax liability of Alpha Ltd. and Beta Ltd. for A.Y.2026-27. Alpha Ltd. has not opted for any concessional rates earlier and want to avail the beneficial tax rates under the special provisions of the Income-tax Act, 1961 in the P.Y. 2025-26. Beta Ltd. has already opted for the concessional tax rates under section 115BAB and wants to continue the same in P.Y. 2025-26. Assume that the gross total income reflects the computation under the special provisions.*

(ii) *Would it be beneficial for Alpha Ltd. to opt for beneficial tax rates in P.Y. 2025-26 instead of paying tax under regular provisions of the Income-tax Act, 1961? Examine.*

Answers

1. Computation of Total Income of XYZ Ltd. for the A.Y.2026-27

Particulars	Amount (₹)	
Profits and Gains from Business and Profession		
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	50,00,000	
(b) Employees' contribution to EPF	2,00,000	
[Since employees' contribution to EPF has not been deposited on or before the due date under the PF Act, the same is not allowable as deduction as per *Explanation 2* below to section 36(1)(va). Since the same has been debited to Statement of profit and loss, it has to be added back for computing business income].		
(b) Employer's contribution to EPF	Nil	
[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 Statement of profit and loss, no further adjustment is necessary]		
(d) Provision for wages payable to workers	Nil	
[The provision is based on fair estimate of wages and reasonable certainty of revision, the provision is allowable as deduction, since ICDS X requires 'reasonable certainty for recognition of a provision, which is present in this case. As the provision has been debited to Statement of profit and loss, no adjustment is required while computing business income]		
(e) Provision for doubtful debts [10% of ₹ 200 lakhs]	20,00,000	
[Provision for doubtful debts is allowable as deduction under section 36(1)(viia) only in case of banks, public financial institutions, state financial corporations, state industrial investment corporations		

	and non-banking financial corporations. Such provision is not allowable as deduction in the case of a manufacturing company. Since the same has been debited to Statement of profit and loss, it has to be added back for computing business income]		
(f)	**Bad debts written off** [Bad debts write off in the books of account is allowable as deduction under section 36(1)(vii). Since the same has already been debited to Statement of profit and loss, no further adjustment is required]	Nil	
(i)	**Provision for gratuity** [Provision of ₹ 500 lakhs for gratuity based on actuarial valuation is not allowable as deduction as per section 40A(7). However, actual gratuity of ₹ 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 ₹ 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 Statement of profit and loss, and tax has been deducted at source, no further adjustment is required]	Nil	
(k)	**Purchase of paper at a price higher than the fair market value** [As per section 40A(2), the difference between the purchase price (₹ 30,000 per ton) and the fair market value (₹ 28,000 per ton) multiplied by the quantity purchased (500 tons) has to be added back since the purchase is from a related party, a firm in which majority of the directors are partners, at a price higher than the fair market value]	10,00,000	
AI(vi)	**GST not refunded to customers out of GST refund** [The amount of GST refunded to the company by the Government is a revenue receipt chargeable to tax under section 41(1). Deduction can be claimed of amount refunded to customers *[CIT v. Thirumalaiswamy Naidu & Sons (1998) 230 ITR 534 (SC)]*. Hence, the net amount of ₹ 1,00,000 (i.e., ₹ 3,00,000 minus ₹ 2,00,000) would be chargeable to tax]	1,00,000	2,83,00,000
			9,83,00,000

Less: **Items credited but to be considered separately/ permissible expenditure and allowances**		
(k) 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 Statement of profit and loss, no adjustment is required].	Nil	
(g) 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 Statement of profit and loss, no further adjustment is required]	Nil	
(h) Over-valuation of stock [₹ 55 lakhs × 10/110] [The amount by which stock is over-valued has to be reduced for computing business income. ₹ 50 lakhs, being the difference between closing and opening stock, has to be adjusted to remove the effect of over-valuation]	5,00,000	
AI(i) Additional Depreciation [Additional depreciation@20% is allowable on ₹ 50 lakhs, being actual cost of new plant & machinery acquired on 10.06.2025, as the same was put to use for more than 180 days in the P.Y.2025-26.]	10,00,000	
AI(ii) Depreciation as per Income-tax Act, 1961	80,00,000	
AI(iii) Payment to a sub-contractor where tax deducted last year was remitted after the due date of filing of return [30% of ₹ 10 lakhs, being payment to a sub-contractor, would have been disallowed under section 40(a)(ia) while computing the business income of A.Y.2025-26, since tax deducted was remitted after the due date of filing of return. However, the same is allowable in A.Y.2026-27, since the remittance has been made on 31.12.2025]	3,00,000	98,00,000
Total Income		**8,85,00,000**

Computation of tax liability of XYZ Ltd. for A.Y.2026-27

Particulars	₹
Tax @30% on the above total income (since the turnover exceeded ₹400 crore in the P.Y. 2023-24)	2,65,50,000
Add: Surcharge @ 7% (since total income exceeds ₹1 crore but less than ₹ 10 crore)	18,58,500
	2,84,08,500
Add: Health and Education cess @ 4%	11,36,340
Total tax liability	**2,95,44,840**

2. Computation of Total Income of Parik Hospitality Ltd. for the A.Y.2026-27

Particulars	Amount (₹)	
Profit as per Statement of profit and loss		1,52,00,000
***Add:* Items debited but to be considered separately or to be disallowed**		
(a) Payment to middleman for purchase of raw corn etc. in an amount exceeding ₹ 10,000 [Under section 40A(3), disallowance is attracted in respect of expenditure for which cash payment exceeding ₹ 10,000 is made on a day to a person. Payment of ₹ 25,000 to farmer for purchase of corn is covered by exception under Rule 6DD. However, payment of ₹ 30,000 to spice trader is not covered under the exception - *CBDT Circular 27/2017 dated 3/11/2017*].	30,000	
(b) Contribution towards employees' pension scheme [Contribution to the extent of 14% of salary (basic salary + dearness allowance, if it forms part of pay for retirement benefits) is allowable as deduction under section 36(1)(iva). Accordingly, no disallowance is required to be made since contribution made is within the prescribed limit.]	-	
(c) Payment to transport contractor without deduction of tax at source [Since the contractor opts for presumptive taxation under section 44AE and furnished a declaration to this effect, tax is not required to be deducted at source under section 194C in respect of payment to transport contractor].	-	

(e) Contribution to IIT for scientific research [Contribution to IIT for scientific research programme approved by the prescribed authority qualifies for deduction @100% under section 35(2AA). Since the amount of contribution has already been debited to the statement of profit and loss, there is no further adjustment required].	-	
(f) Expenses on foreign travel of two directors for a collaboration agreement which failed to materialize [Where expenditure is incurred for a project not related to the existing business and the project was abandoned without creating a new asset, the expenses are capital in nature as per *Mc Gaw-Ravindra Laboratories (India) Ltd. v. CIT (1994) 210 ITR 1002 (Guj.).* Brewery project is not related to the existing business of running three - star hotels]	10,00,000	
(g) Fees paid to directors without deducting tax at source [30% of ₹1 lakh] [Disallowance @ 30% would be attracted under section 40(a)(ia) for non-deduction of tax at source from director's remuneration on which tax is deductible under section 194J]	30,000	10,60,000
		1,62,60,000
***Less:* Items credited but to be considered separately/ Expenditure to be allowed**		
(d) Profit on sale of plot of land to 100% subsidiary [Profit on sale of plot of land taxable or otherwise under the head "Capital Gains". Since this amount has been credited to the statement of profit and loss, the same has to be deducted for computing business income].	12,00,000	
(h) & AI(ii) Depreciation [Depreciation allowable under the Income-tax Act, 1961 is ₹ 15 lakhs whereas the depreciation as per books of account debited to the statement of profit and loss is ₹ 10 lakhs. Hence, the additional amount of ₹ 5 lakhs has to be deducted while computing business income]	5,00,000	
(i) Additional compensation received from State Government [Additional compensation is taxable or otherwise under the head "Capital Gains". Since the compensation has been credited to the statement of profit and loss, the same has to be deducted while computing business income]	10,00,000	

(j) Dividend received from foreign company [Dividend received from foreign company is taxable under the head "Income from other sources". Since the said dividend has been credited to the statement of profit and loss, the same has to be deducted while computing business income]	5,00,000	
AI(i) Interest paid during the year [Conversion of unpaid interest into loan shall not be construed as payment of interest for the purpose section 43B. The amount of unpaid interest converted into a new loan will be allowable as deduction only in the year in which such converted loan is actually paid. Since ₹ 2 lakhs has been paid in the P.Y.2025-26, the same is allowable as deduction]	2,00,000	
AI(iii) Purchases omitted to be recorded in the books [Since the purchase is made in March, 2026 (i.e., P.Y.2025-26), in respect of which bill of ₹ 2 lakhs received on 31.3.2026 has been omitted to be recorded in the books in that year, it has to be deducted to compute the business income *[Kedarnath Jute Manufacturing Company Ltd. v. CIT (1971) 82 ITR 363 (SC)]*. It is logical to assume that the company is following mercantile system of accounting].	2,00,000	36,00,000
Income under the head "Profits and Gains of Business or Profession"		**1,26,60,000**
Capital Gains		
Profit on sale of plot of land to 100% subsidiary [Short-term capital gains arise on sale of plot of land held for less than 24 months. However, in this case, since the transfer is to a 100% subsidiary company and the subsidiary company is an Indian company, the same would not constitute a transfer for levy of capital gains tax as per section 47(iv).]	-	
Additional compensation received from State Government [Since the additional compensation has been received pursuant to an interim order of the Court, the same would be deemed as income chargeable to tax under the head "Capital Gains" in the year of final order as per section 45(5).]	-	

Income from Other Sources		
Dividend received from foreign company [Dividend received from a foreign company is chargeable to tax under the head "Income from other sources".]		5,00,000
Gross Total Income		**1,31,60,000**
Less: **Deduction under Chapter VI-A**		
Deduction u/s 80M in respect of inter-corporate dividends [to the extent of dividend distributed by it on or before the due date specified u/s 139(1) of filing return of income]		5,00,000
Total Income		**1,26,60,000**

3. Computation of total income of M/s Hyper Ltd. for the A.Y. 2026-27

Particulars	₹	₹
Profit as per Statement of Profit & Loss		14,25,000
Add: **Items disallowed/considered separately**		
Provision for loss of subsidiary [since it is not wholly and exclusively for the purpose of business of the assessee]	85,000	
Provision for income-tax [disallowed under section 40(a)(ii)]	1,05,000	
Interest on deposit credited to buyers on 31.3.2026 and tax deducted in April 2026 which was deposited on 31.7.2026 [30% disallowed under section 40(a)(ia) since tax is deducted only in the next year].	30,000	
Depreciation debited to statement of profit and loss [only depreciation calculated as per the Income-tax Rules, 1962 is allowable as deduction]	3,60,000	5,80,000
		20,05,000
Less: **Items credited but not includible under business income or are exempt under the provisions of the Act**		
Long-term capital gain on sale of equity shares on which securities transaction tax was paid, since it is not a business income.	3,60,000	
Income from units of UTI, since it is not a business income.	75,000	4,35,000
		15,70,000
Less: Depreciation (allowable as per the Income-tax Rules, 1962)		2,80,000
		12,90,000

Less: Set-off of brought forward business loss and unabsorbed depreciation		
Brought forward business loss under section 72	4,20,000	
Brought forward depreciation under section 32	6,40,000	10,60,000
Income from business		**2,30,000**
Capital Gains		
Long term capital gain on sale of equity shares on which securities transaction tax was paid at the time of acquisition and sale		3,60,000
Income from Other Sources		
Income from units of UTI		75,000
Total Income		**6,65,000**
Tax on LTCG exceeding ₹ 1.25 lakhs @ 12.5% of ₹ 2,35,000		29,375
Tax on other income of ₹ 3,05,000 @ 30%		91,500
		1,20,875
Add: Health and Education cess @ 4%		4,835
Tax Payable as per the Income-tax Act, 1961		**1,25,710**

Computation of Book Profit under section 115JB

Particulars	₹	₹
Profit as per Statement of Profit & Loss		14,25,000
Add: **Net Profit to be increased by the following amounts as per *Explanation 1* below section 115JB(2)**		
Provision for loss of subsidiary	85,000	
Provision for income-tax	1,05,000	
Depreciation debited to statement of profit and loss	3,60,000	5,50,000
		19,75,000
Less: **Net Profit to be reduced by the following amounts as per *Explanation 1* below section 115JB(2)**		
Depreciation debited to statement of profit and loss (excluding depreciation on account of revaluation of fixed assets) (i.e., ₹ 3,60,000 – ₹ 1,50,000)	2,10,000	

Brought forward business loss or unabsorbed deprecation as per books of account, whichever is less, taken on cumulative basis	6,00,000	8,10,000
Book Profit		**11,65,000**
15% of book profit		1,74,750
Add: Health and Education cess @4%		6,990
Minimum Alternate Tax u/s 115JB		**1,81,740**

In case of a company, it has been provided that where income-tax payable on total income computed as per the provisions of the Act is less than 15% of book profit, the book profit shall be deemed as the total income and the tax payable on such total income shall be 15% thereof plus health and education cess @4%.

Accordingly, in this case, since income-tax payable on total income computed as per the provisions of the Act is less than 15% of book profit, the book profit of ₹ 11,65,000 is deemed to be the total income and income-tax is payable @ 15% thereof plus health and education cess @4%. The tax liability, therefore, works out to be ₹1,81,740.

Computation of tax credit

Particulars	₹
Tax on book profit under section 115JB	1,81,740
Less: Tax on total income computed as per the other provisions of the Act	1,25,710
Tax credit to be carried forward under section 115JAA [Can be carried forward for 15 assessment years succeeding A.Y. 2026-27]	**56,030**

4. Computation of book profit of XYZ Ltd. for the year ended 31.3.2026

Particulars	₹	₹
Profit as per Statement of Profit & Loss		1,90,00,000
***Add:* Net profit to be increased by the following amounts as per *Explanation 1* below section 115JB(2)**		
Depreciation on assets debited to Statement of P& L	1,00,00,000	
Reserve for currency exchange fluctuation, since the amount carried to any reserve, by whatever name called, is to be added back	50,00,000	
Provision for tax **(See Note below)**	40,00,000	
Proposed dividend	1,20,00,000	3,10,00,000
		5,00,00,000

***Less:* Net profit to be decreased by the following amounts as per *Explanation 1* below section 115JB(2)**		
Depreciation other than depreciation on revaluation of assets (₹ 100 lakhs - ₹ 40 lakhs)	60,00,000	
Withdrawal from revaluation reserve restricted to the extent of depreciation on account of revaluation of assets (₹ 50 lakhs or ₹ 40 lakhs, whichever is less)	40,00,000	
Unabsorbed depreciation or brought forward business loss, whichever is less, as per the books of account. Unabsorbed depreciation ₹ 10 lakhs and brought forward business loss ₹ 20 lakhs – whichever is less	10,00,000	1,10,00,000
Book profit		**3,90,00,000**

Note – For the purpose of section 115JB, book profit means the profit as per the statement of profit and loss prepared in accordance with Schedule III to the Companies Act, 2013, as adjusted by certain additions/deductions as specified. One of the adjustments is to add back income-tax paid or payable, and the provisions therefor. *Explanation 2* after sub-section (2) of section 115JB clarifies that income-tax includes, *inter alia*, interest on income-tax. Therefore, the entire provision of ₹ 40 lakhs for income-tax is added back for computing book profit for levy of minimum alternate tax.

5. Computation of total income and tax payable by Mr. Harish for the A.Y. 2026-27 under the normal provisions of the Act

Particulars	₹	₹
<u>Income from house property</u>		
Self-occupied portion (50%)		
Annual Value under section 23(2)	Nil	
Less: Deduction under section 24(b)		
Interest on housing loan [₹ 52,000 × 50%]	26,000	(26,000)
Let-out portion (50%)		
Income of let out portion being rent of ₹ 8,500 p.m. received for 12 months[1]		
Gross Annual Value under section 23(1) (₹ 8,500 × 12)	1,02,000	

[1] Rent received has been taken as the GAV in the absence of other information.

Less: 50% of municipal taxes paid allowable in respect of rented out portion (i.e., 50% of ₹ 2,500)	1,250	
Net Annual Value (NAV)	1,00,750	
***Less:* Deduction under section 24**		
30% of NAV under section 24(a)	30,225	
Interest on housing loan under section 24(b)	26,000	44,525
		18,525
<u>Profits and gains of business or profession</u>		
Net profit as per profit and loss account of wholesale business of textiles and fabrics	3,65,500	
Add: Expenses charged in profit and loss account either not allowable or to be considered separately -		
Personal travelling expenses of proprietor	12,750	
Purchase of furniture wrongly debited to shop expenses	25,000	
	4,03,250	
Less: Depreciation on furniture @10% on ₹ 25,000	2,500	4,00,750
Gross Total Income		**4,19,275**
Less: **Deduction under Chapter VI-A**		
Under section 80C - Life insurance premium		
Self	12,500	
Wife	13,500	
Son and daughter	28,000	
- Housing loan repaid	50,000	
	1,04,000	
Under section 80D [Medical insurance premium]		
Mediclaim insurance premium of ₹ 55,000 [maximum deductible is ₹ 50,000 where it covers a resident senior citizen]	50,000	1,54,000
Total Income		**2,65,275**
Total Income (rounded off)		**2,65,280**
Tax on total income of ₹ 2,65,280 (The basic exemption limit for senior citizen is ₹ 3,00,000 for A.Y.2026-27 under the normal provisions of the Act)		Nil

6. Computation of total income and tax liability of PQR LLP for A.Y.2026-27 (under the regular provisions of the Income-tax Act, 1961)

Particulars	₹	₹
Profits and gains of business or profession		
Unit in SEZ		40,00,000
Profit from operation of warehousing facility	1,05,00,000	
Less: Deduction under section 35AD **[See Note (1) below]**	65,00,000	
Business income of warehousing facility chargeable to tax		40,00,000
Gross Total Income		**80,00,000**
Less: Deduction under section 10AA **[See Note (2) below]**		16,00,000
Total Income		**64,00,000**
Computation of tax liability (under the normal/regular provisions)		
Tax @ 30% on ₹ 64,00,000		19,20,000
Add: Health and Education cess @ 4%		76,800
Total tax liability		**19,96,800**

Computation of adjusted total income of PQR LLP for levy of Alternate Minimum Tax

Particulars	₹	₹
Total Income (as computed above)		**64,00,000**
Add: Deduction under section 10AA		16,00,000
		80,00,000
Add: Deduction under section 35AD	65,00,000	
Less: Depreciation under section 32		
On building @10% of ₹ 65 lakhs[2]	6,50,000	58,50,000
Adjusted Total Income		**1,38,50,000**
Alternate Minimum Tax @18.5%		25,62,250
Add: Surcharge@12% (since adjusted total income > ₹ 1 crore)		3,07,470
		28,69,720
Add: Health and Education cess@4%		1,14,789
		29,84,509
Tax liability under section 115JC (rounded off)		**29,84,510**

[2]Assuming the capital expenditure of ₹ 65 lakhs is incurred entirely on buildings

Since the regular income-tax liability is less than the alternate minimum tax liability, the adjusted total income shall be deemed to be the total income and tax is leviable @18.5% thereof *plus* surcharge @ 12% and cess @4%. Therefore, the tax liability is ₹ 29,84,510.

AMT Credit to be carried forward under section 115JD

	₹
Tax liability under section 115JC	29,84,510
Less: Tax liability under the regular provisions of the Income-tax Act, 1961	19,96,800
	9,87,710

Notes:

(1) Deduction @100% of the capital expenditure is available under section 35AD for A.Y.2026-27 in respect of specified business of setting up and operating a warehousing facility for storage of agricultural produce which commences operation on or after 01.04.2009.

Further, the expenditure incurred, wholly and exclusively, for the purposes of such specified business, shall be allowed as deduction during the previous year in which it commences operations of specified business if the expenditure is incurred prior to the commencement of its operations and the amount is capitalized in the books of account of the assessee on the date of commencement of its operations.

Deduction under section 35AD would, however, not be available on expenditure incurred on acquisition of land.

In this case, since the capital expenditure of ₹ 65 lakhs (i.e., ₹ 75 lakhs – ₹ 10 lakhs, being expenditure on acquisition of land) has been incurred in the F.Y. 2024-25 and capitalized in the books of account on 1.4.2025, being the date when the warehouse became operational, ₹ 65,00,000, being 100% of ₹ 65 lakhs would qualify for deduction under section 35AD.

(2) **Deduction under section 10AA in respect of Unit in SEZ =**

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

$$₹\ 40{,}00{,}000 \times \frac{₹\ 80{,}00{,}000}{₹\ 1{,}00{,}00{,}000} \times 50\ \% = \mathbf{₹\ 16{,}00{,}000}$$

7. As per section 80AC, while computing the total income of an assessee of a previous year ***(P.Y.2025-26, in this case)*** relevant to any assessment year ***(A.Y.2026-27, in this case)***, any deduction is admissible, *inter alia,* under section 80-IA, such deduction shall not be allowed unless it furnishes a return of income for such assessment year on or before the 'due date' specified in section 139(1).

Since the turnover of the partnership firm has exceeded the prescribed threshold limit in the previous year 2025-26, it would be subject to audit under section 44AB, in which case the 'due date' of filing its return of income for A.Y.2026-27 would be 31st October, 2026 as per section 139(1).

Computation of total income and tax liability of M/s. Victory Polyfibres for A.Y. 2026-27

I. Where the firm files its return of income on 31st October 2026:

Particulars	₹ in lakhs
Gross Total Income	300.00
Less: Deduction under section 80-IA	200.00
Total Income	**100.00**
Tax liability@ 30%	30.00
Add: Health and Education cess@4%	1.20
Regular income-tax payable	**31.20**

Computation of Alternate Minimum Tax payable [Section 115JC]

Particulars	₹ in lakhs
Total Income	100.00
Add: Deduction under section 80-IA	200.00
Adjusted Total Income	**300.00**
Alternate Minimum Tax (AMT) @ 18.5% on ₹ 300 lakhs	55.50
Add: Surcharge@12% (Since adjusted total income > ₹ 1 crore)	6.66
	62.16
Add: Health and Education cess@4%	2.49
Total tax payable (AMT)	**64.65**

Since the regular income-tax payable by the firm is less than the alternate minimum tax payable, the adjusted total income shall be deemed to be the total income of the firm for P.Y.2025-26 and it shall be liable to pay income-tax on such total income @ 18.5% **[Section 115JC(1)]**. Therefore, the tax payable for the A.Y. 2026-27 would be ₹ 64.65 lakhs.

Tax credit for Alternate Minimum Tax [Section 115JD]

	₹ in lakhs
Total tax payable for A.Y.2026-27 (Alternate Minimum Tax)	64.65
Less: Regular income-tax payable	31.20
To be carried forward for set-off against regular income-tax payable (upto a maximum of fifteen assessment years).	33.45

II. Where the firm files its return of income on 7th December 2026:

Where the firm files its return on 7-12-2026, it would be a belated return under section 139(4). Consequently, as per section 80AC, deduction under 80-IA would not be available. In such circumstances, the gross total income of ₹ 300 lakhs would be the total income of the firm.

Particulars	₹ in lakhs
Income-tax @ 30% of ₹ 300 lakhs	90.000
Add: Surcharge @12% (since total income exceeds ₹ 1 crore)	10.800
Income-tax (plus surcharge)	100.800
Add: Health and Education cess @ 4%	4.032
Total tax liability	**104.832**

Practical solution regarding obtaining clarifications:

The practical solution regarding obtaining clarifications would be to file the return of income under section 139(1) on or before the 'due date', i.e., 31.10.2026, and claim deduction under section 80-IA. In such a case, the firm can claim deduction of ₹ 200 lakhs under section 80-IA. Thereafter, consequent to the clarifications obtained, if any change is required, it can file a revised return under section 139(5) by 31.12.2026 which would replace the original return filed under section 139(1). A revised return filed under section 139(5) would replace the original return filed under section 139(1).

If the firm files the return of income under section 139(1) on or before 31.10.2026, its tax liability would stand reduced to ₹ 64.65 lakhs, as against ₹ 104.832 lakhs to be paid if return is furnished after due date. Further, it would also be eligible for tax credit for alternate minimum tax under section 115JD to the extent of ₹ 33.45 lakhs. Therefore, the firm is advised to file its return of income on or before 31.10.2026.

8. (i) Computation of total income of the AOP for A.Y.2026-27

Particulars	₹
Profit & gains of business **(See Working Note below)**	3,12,300
Long term capital gain	6,40,000
Income from other sources - Dividend from Indian companies	25,000
Total income	9,77,300

Working Note - Computation of profits and gains of business

Particulars	₹	₹
Net profit as per profit & loss account		5,24,300
Add: Inadmissible payments		
Interest to members T & Q (₹ 48,300 + ₹ 35,700)	84,000	
Advertising [Disallowance under section 40A(3) (100% of ₹ 30,000 being a cash payment)]	30,000	
Remuneration to members T & Q (₹ 1,30,000 + ₹1,70,000)	3,00,000	
GST penalty **(See Note 3 below)**	39,000	4,53,000
		9,77,300
Less: Income not taxable under this head		
Long term capital gain	6,40,000	
Dividend from Indian companies	25,000	6,65,000
Profits and gains of business		**3,12,300**

Notes:

1. Since the employer's contribution to PF has been paid during the previous year itself, it is allowable as deduction.

2. Penalty imposed for delay in filing GST return is not deductible since it is on account of infraction of the law requiring filing of the return within the specified period. – *CIT v. Ratanchand Bholanath (S.S) (1986) 160 ITR 500 (M.P.)*

(ii) Tax implication in the hands of members T & Q for the A.Y. 2026-27

Members of the AOPs have to pay tax on their total income taking into account savings/ investments etc.

Since one of the members has total income excluding share from AOP more than the basic exemption limit, the AOPs will be chargeable to tax at the maximum marginal rate.

Since the AOPs is taxed at maximum marginal rate, the share income of members is not taxable in their hands individually as per section 86.

9. Transfer fees received by a co-operative housing society, whether from outgoing or from incoming members, is not liable to tax on the ground of principle of mutuality where the predominant activity of such co-operative society is maintenance of property of the society. It was so held by the Bombay High Court in *Sind Co-op Housing Society v. ITO (2009) 317 ITR 47*.

Further, section 28(iii), which provides that income derived by a trade, professional or similar association from specific services performed for its members shall be treated as business income, can have no application since the co-operative housing society is not a trade or professional association.

Therefore, ₹ 6 lakhs received as transfer fees by Pandey Co-operative Housing Society from its transferor members and its transferees, is not chargeable to tax.

10. Computation of total income and tax liability of M/s. Beta & Co., a partnership firm, as per the normal provisions of the Act for A.Y. 2026-27

Particulars		₹ (in lakhs)
Business income (before deduction under section 10AA)		
SEZ Unit		50.00
Add: Amount debited to SEZ Re-investment Reserve		20.00
		70.00
DTA Unit		40.00
Gross Total Income		110.00
Less: Deduction u/s 10AA		
= ₹ 70 lakhs × ₹ 150 lakhs/₹ 210 lakhs = 50 × 50% (being the 13^{th} year)	25.00	
Amount credited to SEZ Re-investment Reserve Account	20.00	
whichever is less is deductible		**20.00**
Total Income		**90.00**
Tax on total income@30%		27.00
Add: Health and Education Cess@4%		1.08
Tax liability (as per normal provisions)		**28.08**

Computation of Adjusted total income and Alternate Minimum tax of M/s. Beta & Co., a partnership firm, as per the provisions of section 115JC for A.Y.2026-27

Particulars	₹ (in lakh)
Total income as per the normal provisions	90.00
Add: Deduction under section 10AA	20.00
Adjusted total income	110.00
Tax@18.5% of Adjusted Total Income	20.350
Add: Surcharge @12% as the adjusted total income is > ₹ 1 crore	2.442
	22.792
Add: Health and Education cess @4%	0.912
Alternate Minimum Tax as per section 115JC	**23.704**

Since the tax liability as per the normal provisions of the Act is more than the alternate minimum tax payable, the total income as per normal provisions shall be liable to tax and the tax payable for A.Y. 2026-27 shall be ₹ 28.08 lakhs.

11. Computation of Total Income of Lambda Ltd. for the A.Y. 2026-27

	Particulars	Amount (₹)	
I	**Profits and gains of business and profession**		
	Net profit as per the statement of profit and loss		7,50,00,000
	Add: **Items debited but to be considered separately or items of expenditure to be disallowed**		
	(a) **Depreciation as per Companies Act**	52,00,000	
	(c) **Provision for wages payable to workers**	-	
	[Since the provision is based on a fair estimate of wages payable with reasonable certainty, the provision is allowable as deduction. ICDS X requires a reliable estimate of the amount of obligation and 'reasonable certainty' for recognition of a provision, which is present in this case.		
	As the provision of ₹ 18 lakhs has been debited to statement of profit and loss, no adjustment is required while computing business income]		

	(e) **Loss due to destruction of machinery by fire** [Loss of ₹ 17 lakhs due to destruction of machinery caused by fire is not deductible since it is capital in nature. Since the loss has been debited to statement of profit and loss, the same is required to added back while computing business income]	17,00,000	
	(f) **Provision for gratuity** [Provision of ₹ 320 lakhs for gratuity based on actuarial valuation is not allowable as deduction. However, actual gratuity of ₹ 160 lakhs paid is allowable as deduction. Hence, the difference has to be added back to income [₹ 320 lakhs (-) ₹ 160 lakhs]	1,60,00,000	
	(g) **Advertisement in souvenir of a political party** [Advertisement charges paid in respect of souvenir published by a political party is not allowable as deduction from business profits of the company. Since the expenditure has been debited to statement of profit and loss, the same has to be added back while computing business income]	2,30,000	2,31,30,000
			9,81,30,000
	***Add:* Income taxable but not credited to statement of profit and loss**		
	AI(ii) **GST not refunded to customers out of GST refund received from State Govt.** [The amount of GST refunded to the company by the Government is a revenue receipt chargeable to tax. Out of the refunded amount of ₹ 3 lakhs, the amount of ₹ 2 lakh stands refunded to customers would not be chargeable to tax.[3] The balance amount of ₹ 1,00,000 lying with the company would be chargeable to tax]		1,00,000
			9,82,30,000

[3]*CIT v. Thirumalaiswamy Naidu & Sons (1998) 230 ITR 534 (SC)*

	Less: **Items credited to statement of profit and loss, but not includible in business income/ permissible expenditure and allowances**		
	(b) **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. Since the same has been credited to statement of profit and loss, no adjustment is required]		
	(d) **Dividend received from US company**	12,00,000	
	[Dividend received from foreign company is taxable under "Income from other sources". Since the same has been credited to the statement of profit and loss, it has to be deducted while computing business income]		
	(e) **Scrap value of machinery**	3,00,000	
	[Scrap value of machinery, being capital in nature, has to be reduced from WDV of machinery. Since the same has been credited to the statement of profit and loss, it has to be deducted while computing business income]		
	(h) **Long term capital gains on sale of equity shares**	3,00,000	
	[The taxability or otherwise of long-term capital gain on sale of equity shares has to be considered while computing income under the head "Capital Gains". Since such capital gains has been credited to statement of profit and loss, the same has to be reduced to arrive at the business income.]		
	AI(i) **Depreciation as per Income-tax Rules, 1961**	71,00,000	89,00,000
	Profits and gains from business and profession		**8,93,30,000**
II	**Capital Gains**		
	Long term capital gain on sale of equity shares		3,00,000
	[Long term capital gains in excess of ₹ 1.25 lakhs (i.e., ₹ 1.75 lakhs, being ₹ 3 lakh – ₹ 1.25 lakhs) on sale of equity shares on which STT is paid at the time of acquisition and sale would be taxable@12.5% u/s 112A, without indexation benefit.]		

III	**Income from Other Sources**		
	Dividend received from foreign company		12,00,000
	[Dividend received from a foreign company is chargeable to tax under the head" Income from other sources"]		
	Gross Total Income		**9,08,30,000**
	***Less:* Deduction under Chapter VI-A**		
	Under section 80GGB [Contribution by a company to a registered political party is allowable as deduction, since payment is made otherwise than by cash. Expenditure incurred by an Indian company on advertisement in souvenir published by such political party tantamount to contribution to such political party.]		2,30,000
	Total Income		**9,06,00,000**

12. Computation of Total Income of M/s. Popular Cine Vision for the A.Y.2026-27

Particulars	₹	₹
Profits and Gains from Business or Profession		
Net Profit as per Profit & Loss A/c		10,00,000
Add: Expenses disallowed or considered separately:		
Interest to partners in excess of 12% **(Note 1)**	3,00,000	
Disallowance under section 40A(3) for aggregate cash payment exceeding ₹ 10,000 in a single day **(Note 5)**	52,000	
Provision for gratuity **(Note 7)**	4,50,000	
Partners' Remuneration	30,00,000	
Royalty paid to Partner X **(Note 4)**	5,00,000	43,02,000
		53,02,000
Less: Interest on income-tax refund **(Note 8)**		1,20,000
Book Profit		**51,82,000**
Less: Partners' remuneration allowable under section 40(b)(v)		
(i) As per limit prescribed in section 40(b)		
On first ₹ 6,00,000 90%	5,40,000	
On the balance ₹ 45,82,000 60%	27,49,200	
	32,89,200	

(ii) Remuneration actually paid or payable (₹ 1,00,000 × 10 months × 3 partners) + (Royalty ₹ 5 lakhs)		
(i) or (ii) whichever is less, is deductible	35,00,000	32,89,200
		18,92,800
Income from other sources		
Interest on income-tax refund		1,20,000
Gross Total Income		**21,02,800**
Deductions under Chapter VI-A		Nil
Total Income		**21,02,800**

Notes:

1. As per section 40(b), simple interest at 12% p.a. to partners relating to the period after the date of partnership deed is allowable. Excess interest @ 3% paid from 1st June 2025 to 31st March 2026 is to be disallowed. Excess interest of 3% being ₹15,00,000 x 3/15 = ₹ 3,00,000.

2. Even though Z is a partner in a representative capacity, he is still a partner. Therefore, remuneration to Z should also be subject to the limits prescribed in section 40(b). This view finds support from the decision of the Supreme Court in the case of *Rashik Lal & Co. vs CIT (1998) 229 ITR 458 (SC).*

3. As per *Explanation 1* to section 40(b), where an individual is a partner in a firm in representative capacity, the provisions of section 40(b) shall not apply to any interest payable by the firm to such individual in his personal capacity. Z represents his HUF in the firm. However, Z gave the loan in his individual capacity. Hence, assuming that the provisions of section 40A(2) do not get attracted in this case, such interest shall be allowed as deduction in full even though the interest rate is more than 12% p.a.

4. It may be noted that the limits specified under section 40(b)(v) are applicable in case of payment of salary, bonus, commission, or remuneration, by whatever name called, to a working partner. From a plain reading of the section, it is clear that any remuneration, by whatever name called, paid to a working partner, is subject to the limits laid down in section 40(b)(v). Therefore, the royalty of ₹ 5 lakhs paid to partner X would also be subject to the limits laid down in section 40(b)(v). Hence, the same has to be added back for computing book profits.

5. Section 40A(3) provides for disallowance of any expenditure in respect of which the actual payment exceeding ₹ 10,000 is made otherwise than by an account payee cheque, account payee bank draft or use of ECS through bank account or through such other electronic mode as may be prescribed in a single day to a person. Hence, the payments of ₹ 18,000 and ₹ 15,000 in cash on 1.2.2026 to Altaf, a hairdresser, shall be disallowed, since the aggregate payment of ₹ 33,000 exceeds the limit of ₹ 10,000.

   The payment of bill of the assistant cameraman of ₹ 19,000 on 1st February is also liable for disallowance under section 40A(3) since the aggregate payment in cash on a single day has exceeded ₹ 10,000.

6. As per section 40(a)(i), any sum payable to a non-resident shall not be allowed as deduction, if tax has not been deducted at source or after deduction, has not been paid on or before the due date specified under section 139(1). Tax deducted from the amount of remuneration credited to payee's account on 31st March 2026 has to be deposited latest by 31st July 2026/ 31st October 2026 (as the case may be). The firm has paid the tax on 3rd June 2026 and hence, the remuneration shall be allowed. Since the same is already debited to profit and loss account, no further adjustment is made.

7. As per section 40A(7), any provision made for payment of gratuity to employees on their retirement or on termination of employment for any reason is disallowed. However, gratuity of ₹ 1.50 lakhs paid to retired employees is allowable as deduction. Hence, the balance provision of ₹ 4.50 lakhs (i.e., ₹ 6 lakhs – ₹ 1.50 lakhs) is to be disallowed.

8. Interest on income-tax refund is assessable under the head "Income from other sources".

13. (i) Computation of tax liability of Alpha Ltd. and Beta Ltd. under the special provisions of the Income-tax Act, 1961

Particulars	Alpha Ltd. ₹	Beta Ltd. ₹
Gross Total Income	**5,00,00,000**	**5,00,00,000**
Less: Deduction u/s 80JJAA		
Alpha Ltd - [(₹ 20,000 x 12 x 250) + (₹ 25,000 x 12 x 250)] x 30%	4,05,00,000	

Beta Ltd – [(₹ 21,000 x 12 x 250) + (₹ 25,000 x 12 x 250)] x 30%		4,14,00,000
Total Income	**95,00,000**	**86,00,000**
Computation of tax liability		
Tax@22% on ₹ 95,00,000 [As per section 115BAA]	20,90,000	
Tax@15% on ₹ 86,00,000 [As per section 115BAB]		12,90,000
Add: Surcharge@10%	2,09,000	1,29,000
	22,99,000	**14,19,000**
Add: Health and Education cess@4%	91,960	56,760
Total tax liability	**23,90,960**	**14,75,760**

Notes -

(1) Alpha Ltd. is eligible to opt for special provisions under section 115BAA, as per which the rate of tax would be 22% plus surcharge@10% and HEC@4%.

(2) Both Alpha Ltd. and Beta Ltd. are eligible to claim deduction u/s 80JJAA, which is a permissible Chapter VI-A deduction while computing total income under section 115BAA and 115BAB.

In case of Alpha Ltd, 30% of the additional employee cost of new employees employed in the P.Y. 2023-24, can be claimed as deduction u/s 80JJAA for P.Y.2025-26. Out of 750 employees, 250 employees whose emoluments are ₹ 20,000 p.m., 250 employees whose emoluments are ₹ 25,000 p.m. qualify as additional employees and 250 employees whose emoluments exceed ₹ 25,000 p.m. do not qualify as additional employees.

Similarly, in case of Beta Ltd, 30% of the additional employee cost of new employees employed in the P.Y. 2023-24, can be claimed as deduction u/s 80JJAA for P.Y.2025-26. Out of 750 employees, 250 employees whose emoluments are ₹ 21,000 p.m., 250 employees whose emoluments are ₹ 25,000 p.m. qualify as additional employees and 250 employees whose emoluments exceed ₹ 25,000 p.m. do not qualify as additional employees.

(ii) Computation of tax liability of Alpha Ltd. as per the regular provisions of the Act

Particulars	Alpha Ltd. ₹
Gross Total Income (computed under the special provisions)	5,00,00,000
Less: Additional Depreciation [10% of ₹ 8 crore, since the plant and machinery has been put to use for less than 180 days in the P.Y.2025-26]	80,00,000

Gross Total Income (computed under the regular provisions of the Act)	**4,20,00,000**
Less: Deduction u/s 80JJAA	
[(₹ 20,000 x 12 x 250) + (₹ 25,000 x 12 x 250)] x 30%	4,05,00,000
Total Income	**15,00,000**
Computation of tax liability	
Tax@25% on ₹ 15,00,000 [Since turnover of P.Y.2023-24 is less than ₹ 400 crore]	3,75,000
Add: Surcharge (Not applicable, since total income is less than ₹ 1 crore)	Nil
	3,75,000
Add: Health and Education cess@4%	15,000
Total tax liability	**3,90,000**

Since the tax liability under the regular provisions of the Act is ₹ 3,90,000 *vis-à-vis* tax liability of ₹ 23,90,960 computed under section 115BAA, it is not beneficial for Alpha Ltd. to opt for the special provisions under section 115BAA for A.Y.2026-27. Hence, Alpha Ltd. should **not** opt for the special provisions under section 115BAA for A.Y.2026-27.