

STUDY MATERIAL

EXECUTIVE PROGRAMME

TAX LAWS

AND

PRACTICE

MODULE I

PAPER 4



THE INSTITUTE OF
Company Secretaries of India
IN PURSUIT OF PROFESSIONAL EXCELLENCE

Statutory body under an Act of Parliament

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EXECUTIVE PROGRAMME – TAX LAWS AND PRACTICE

This study material has been published to aid the students in preparing for the Tax Laws and Practice paper of the CS Executive Programme. It is part of the educational kit and takes the students step by step through each phase of preparation stressing key concepts, pointers and procedures. Company Secretaryship being a professional course, the examination standards are set very high, with emphasis on knowledge of concepts, applications, procedures and case laws, for which sole reliance on the contents of this study material may not be enough. Besides, as per the Company Secretaries Regulations, 1982, students are expected to be conversant with the amendments to the laws made upto six months preceding the date of examination. The material may, therefore, be regarded as the basic material and must be read alongwith the original Bare Acts, Rules, Orders, Case Laws, Student Company Secretary bulletin published and supplied to the students by the Institute every month as well as recommended readings given with each study lesson.

The subject of Tax Laws is inherently complicated and is subjected to constant refinement through new primary legislations, rules and regulations made thereunder and court decisions on specific legal issues. It therefore becomes necessary for every student to constantly update himself with the various changes made as well as judicial pronouncements rendered from time to time by referring to the Institutes journal 'Chartered Secretary' and e-bulletin 'Student Company Secretary' as well as other law/professional journals on tax laws.

The purpose of this study material is to impart conceptual understanding to the students of the provisions of the Direct Tax Laws (Income Tax and Wealth Tax) and Indirect Tax Laws (Service Tax, Value Added Tax and Central Sales Tax) covered in the Syllabus. The study material contains all relevant amendments made by Finance Act, 2013 and is applicable for the Assessment Year 2014-15 relevant for June 2014 and December 2014 examination. However, it may so happen that some developments might have taken place during the printing of the study material and its supply to the students. The students are therefore, advised to refer to the Student Company Secretary bulletin and other publications for updation of the study material.

The students may note that notified sections of the Companies Act, 2013 does not have any impact on the Finance Act, 2013 which is applicable for December 2014 Examination (Assessment year 2014-15). The Assessment Year for June 2014 and December 2014 examination is 2014-15. Besides all other changes made through Notifications etc. and made effective six months prior to the examination will also be applicable.

In the event of any doubt, students may write to the Directorate of Academics in the Institute at academics@icci.edu for clarification.

Although care has been taken in publishing this study material yet the possibility of errors, omissions and/or discrepancies cannot be ruled out. This publication is released with an understanding that the Institute should not be responsible for any errors, omissions and/or discrepancies or any action taken in that behalf.

Should there be any discrepancy, error or omission noted in the study material, the Institute shall be obliged if the same are brought to its notice for issue of corrigendum in the Student Company Secretary bulletin.

This study material has been updated upto 31st May, 2014.

The Institute has decided that the examination for this paper under new syllabus will be held from December 2014 session in the Optical Mark Recognition (OMR) format, whereby students are required to answer multiple choice questions on OMR sheet by darkening the appropriate choice by HB pencil. One mark will be awarded for each correct answer. There is NO NEGATIVE mark for incorrect answers.

The specimen OMR sheet is appended at the end of the study material. There is practice test paper in the study to acquaint students with the pattern of examination. These are for practice purpose only, not to be sent to the institute.

SYLLABUS

MODULE (I) PAPER 4: TAX LAWS AND PRACTICE

Level of Knowledge: Working Knowledge

Objective: *To acquire expert knowledge of practical and procedural aspects relating to Direct Tax Laws, Service Tax and VAT.*

PART A: INCOME TAX AND WEALTH TAX (70 MARKS)

1. Basics and Definitions – Income Tax Act , 1961

- Background, Concept and Mechanism of Income Tax
- Definitions, Concept of Income, Previous Year, Assessment Year, Distinction between Capital and Revenue Receipts and Expenditure, Residential Status
- Basis of Charge and Scope of Total Income

2. Incomes which do not form part of Total Income

3. Computation of Total Income under Various Heads

Salaries, Income from House Property, Profit and Gains of Business or Profession, Capital Gains, Income from Other Sources

4. Clubbing Of Income, Set-off and Carry-Forward of Losses and Deductions from Total Income

Income of Other Persons included in Assessee's Total Income; Aggregation of Income and Set Off or Carry Forward of Losses; Various Deductions to be made in Computing Total Income, Rebates and Relief's; Applicable Rates of Taxes and Tax Liability

5. Taxation of different kinds of persons

Taxation of Individuals including Non-Residents, Hindu Undivided Family, Firms, LLP, Association of Persons, Cooperative Societies, Trusts, Charitable and Religious Institution

6. Classification and Tax Incidence on Companies

Computation of Taxable Income and Assessment of Tax Liability, Dividend Distribution Tax, Minimum Alternate Tax and Other Special Provisions Relating to Companies

7. Collection and Recovery of Tax

Tax Deduction at Source, Tax Collection at Source, Recovery and Refund of Tax; Provisions of Advance Tax

8. Procedure for Assessment, Appeals, Revisions, Settlement of Cases and Penalties & Offences

Provisions concerning Procedure for Filing Returns, Signatures, E-Filing, Assessment, Reassessment and Settlement of Cases, Special Procedure for Assessment of Search Cases, E-Commerce Transactions, Liability in Special Cases, Refunds, Appeals and Revisions; Penalties Imposable, Offences and Prosecution.

9. Tax Planning & Tax Management

Concept of Tax planning, Tax planning with reference to setting up a New Business; Location; Nature of

Business; Tax Holiday, etc. Tax Planning with regard to Specific Management Decisions such as Mergers and Takeovers; Employees' Remuneration; Voluntary Retirement Tax Planning with reference to Financial Management Decisions such as Borrowing or Investment Decisions; Reorganization or Restructuring of Capital

10. Wealth Tax Act, 1956

- Background, Concept and Charge of Wealth Tax
- Assets, Deemed Assets and Assets Exempt from Tax
- Valuation of Assets, Computation of Net Wealth
- Return of Wealth Tax and Provisions concerning Assessment

11. Basic Concepts of International Taxation

Residency Issues; Source of Income; Tax Havens; Withholding Tax, Unilateral Relief and Double Taxation Avoidance Agreements, Controlled Foreign Corporation, Advance Rulings and Tax Planning, Authority for Advance Rulings,

12. Transfer Pricing

- Concepts, Meaning of International Transactions
- Computation of Arm's Length Price & Methods
- Documentation and Procedural Aspects

13. General Anti Avoidance Rules (GAAR)

PART B - SERVICE TAX & SALES TAX (30 Marks)

14. An Overview of Service Tax

Background, Negative List Approach, Taxable Services, Administrative Mechanism, Registration and Procedural Aspects, Rate and Computation of Tax, Levy, Collection and Payment of Service Tax.

15. An Overview of Value Added Tax

Legislative Background, Concept of VAT, Declared Goods, Administrative Mechanism, Registration and Procedural Aspects, Rate and Computation of Tax, Levy, Collection and Payment of VAT.

16. Central Sales Tax

Tax on Inter- State Trade and Exports - Registration, Preparation and Filing of E-Returns, Rates of Tax, Assessment and Refunds.

LIST OF RECOMMENDED BOOKS

PAPER 4: TAX LAWS AND PRACTICE

READINGS

I. Income Tax and Wealth Tax :

1. Dr. V. K. Singhania : Students Guide to Income-tax including Service Tax/VAT; Taxmann Publications Pvt. Ltd., 59/32, New Rohtak Road, New Delhi – 110 005 (Edition based on provisions applicable for AY 2014-15)
2. Girish Ahuja and Ravi Gupta : Systematic Approach to Income-tax, Service Tax and VAT; Bharat Law House, T-1/95, Mangolpuri Industrial Area, Phase I, New Delhi-110 083. (Edition based on provisions applicable for AY 2014-15)
3. B. B. Lal and N. Vashist : Direct Taxes, Income Tax, Wealth Tax and Tax Planning; Darling Kindersley (India) Pvt. Ltd., 482, FIE, Patparganj, Delhi.-110092 (Edition based on provisions applicable for AY 2014-15)
4. Dr. H. C. Mehrotra and Dr. S.P. Goyal : Direct Taxes (with Tax Planning); Sahitya Bhawan, Agra. (Edition based on provisions applicable for AY 2014-15)
5. Girish Ahuja and Ravi Gupta : Professional Approach to Direct Taxes Law & Practice; Bharat Publications (Edition based on provisions applicable for AY 2014-15)
6. Vikas Mundra : Tax Laws and Practices; Law Point publications, 6C, R.N. Mukherjee Road, Kolkata- 700001 (edition based on provisions applicable for AY 2014-15)

II. Service Tax and Value Added Tax

1. V. S. Datey : Service Tax Ready Reckoner; Taxmann Publications, 59/32, New Rohtak Road, New Delhi
2. J. K. Mittal : Law, Practice & Procedure of Service Tax; CCH India, (Walters Kluwer (India) Pvt. Ltd.), 501-A, Devika Tower, 6 Nehru Place, New Delhi.
3. Balram Sangal and Jagdish Rai Goel : All India VAT manual (4 Vols.); Commercial Law Publisheres (India) Pvt Ltd., 151, Rajendra Market, Opp. Tis Hazari Courts, Delhi – 110 054
4. Vikas Mundra : Tax Laws and Practices; Law Point publications, 6C R.N. Mukherjee Road, Kolkata- 700001 (edition based on provisions applicable for AY 2014-15)

REFERENCES

1. Bare Act : Income Tax Act, 1961 & Income Tax Rules, 1962
2. Sampath Iyengars : Law of Income Tax, 11th Edition; Bharat Law House Pvt. Ltd., T-1/95, Mangolpuri Industrial Area, Phase I, New Delhi-110 083.

Note :

- (i) Students are advised to read the relevant Bare Acts. 'Student Company Secretary' and 'Chartered Secretary' regularly for updating the knowledge.
- (ii) The latest editions of all the books relevant for the applicable assessment year referred to above should be read.

ARRANGEMENT OF STUDY LESSONS

PART A

1. Introduction and Important Definitions
2. Basis of Charge, Scope of Total Income and Residential Status
3. Incomes which do not Form Part of Total Income
4. Computation of Total Income under Various Heads :
 - Part I – Income under head Salaries
 - Part II – Income under head House Property
 - Part III : Income From Business or Profession
 - Part IV – Income from Capital Gains
 - Part V – Income from Other Sources
5. Income of Other Persons Included in Assessee's Total Income and Set-Off or Carry Forward of Losses
6. Deductions from Total Income
7. Computation of Tax Liability of Hindu Undivided Family/ Firm/Association of Persons/Co-operative Societies
8. Computation of Tax Liability of Companies
9. Computation of Tax Liability of Non-resident Assessee
10. Collection and Recovery of Tax
11. Procedure for Assessment
12. Appeals, Revisions, Settlement of Cases and Penalties & Offences
13. Tax Planning & Tax Management
14. Wealth Tax Act, 1956
15. Basic Concepts of International Taxation
16. Advance Ruling and GAAR

PART B

17. Background, Administration and Procedural Aspects of Service Tax
18. Levy, Collection and Payment of Service Tax
19. Value Added Tax – Introduction, Computation and Other Procedural Aspects
20. VAT provisions in India and VAT System in other Countries and Scope for Company Secretaries

CONTENTS

PART A: THE INCOME TAX AND WEALTH TAX ACT

LESSON 1

INTRODUCTION AND IMPORTANT DEFINITIONS

Introduction	3
Basic Concepts of Income Tax Act	3
– Income	4
– Assessee	11
– Person [Section 2(31)]	12
– Assessment Year [Section 2(9)]	13
– Previous Year (Section 3)	13
Computation of Taxable Income and Tax Liability of an Assessee	14
Tax Rates	15
LESSON ROUND UP	16
SELF TEST QUESTIONS	17

LESSON 2

BASIS OF CHARGE, SCOPE OF TOTAL INCOME AND RESIDENTIAL STATUS

Residential Status and Tax Liability (Section 6)	22
– Test for Residence of individuals	22
– Tests of Residence for Hindu Undivided Families, Firms and other Associations of Persons	27
– Tests of Residence for Companies	29
Charge of Income-tax (Section 4)	29
Meaning and Scope of total Income (Section 5)	31
Apportionment of Income between Spouses Governed by Portuguese Civil Code (Section 5A)	39
Tax incidence vis-a-vis Residential Status	40
LESSON ROUND UP	44
SELF TEST QUESTIONS	45

LESSON 3

INCOMES WHICH DO NOT FORM PART OF TOTAL INCOME

General Exemption	50
-------------------	----

	<i>Page</i>
Specific Exemption	93
Special Provisions in respect of Newly Established Units in Special Economic Zone (Section 10AA)	93
Tax Exemptions for Charitable Trusts and institutions	95
Tax Exemptions to Political Parties (Section 13A)	106
Voluntary Contributions received by an Electoral Trust (Section 13B)	107
LESSON ROUND UP	107
SELF TEST QUESTIONS	107

LESSON 4

COMPUTATION OF TOTAL INCOME UNDER VARIOUS HEADS

PART I – INCOME UNDER THE HEAD SALARIES

Basis of Charge	112
Salary [Section 17(1)]	116
Allowances	117
Perquisites [Section 17(2)]	118
Valuation of Perquisites	126
Profits in Lieu of or in Addition to Salary	131
Deductions Allowed from Salaries (Section 16)	133
Provident funds - Treatment of Contributions to and Money Received from the Provident Fund	134
Incomes exempt from Tax and not includable in 'Salary'	135
Tax Deducted at Source	135
LESSON ROUND UP	147
SELF TEST QUESTIONS	148

PART II – INCOME UNDER THE HEAD HOUSE PROPERTY

Basis of Charge	154
Determination of Annual Value Under Section 23	157
Computation of Annual Value/Net Annual Value	158
Deductions from Income under the head House Property (Section 24)	165
Deduction in respect of interest on Housing Loan under section 80EE	166
Special Provision for Cases where Unrealised Rent allowed as Deduction is realised subsequently (Section 25A)	166
Unrealised Rent received subsequently to be Charged to Income-tax (Section 25AA)	167
Taxation of arrears of rent in the year of receipt (Section 25B)	167

	<i>Page</i>
Loss from House Property	167
Exemptions	173
LESSON ROUND UP	174
SELF TEST QUESTIONS	175

PART III : INCOME FROM BUSINESS OR PROFESSION

‘Business’ or ‘Profession’	182
Income Chargeable to Income-Tax (Section 28)	184
Point for consideration while computing income under the head Business or Profession	186
Profits and Losses of Speculation Business	188
Computation of Income under the head “Profits and Gains from Business or Profession”	190
Deductions Allowable	190
Expenses Restricted/Disallowed (Section 40 and Section 40A)	229
Deemed Profits	236
Special Provision for Deductions in the Case of Business for prospecting etc. for Mineral Oil (section 42)	238
Special Provisions Consequential to the Changes in the Rate of Exchange of Currency [Section 43A]	239
Special Provision for Computation of Cost of Acquisition of Certain Assets (Section 43C)	240
Special Provision in Case of Income of Public Financial institutions, Etc. (Section 43D)	241
Insurance Business (Section 44)	241
Special Provisions for Deduction in Case of Trade, Professional or Similar Associations (Section 44A)	241
Maintenance of Accounts (Section 44aa)	242
Compulsory Audit of Accounts of Certain Persons Carrying on Business or Profession (Section 44AB)	243
Special Provision for Computing Profits and Gains of Business on Presumptive Basis (Section 44AD)	244
Special Provisions for Computing Profits and Gains of Business of Plying, Hiring or Leasing Goods Carriages (Section 44AE)	244
Special Provisions for Computing Profits and Gains of Shipping Business in the Case of Non-Residents (Section 44B)	245
Special Provision for Computing Profits and Gains in Connection with the Business of Exploration Etc., of Mineral Oils (Section 44BB)	245
Special Provision for Computing Profits and Gains of the Business of Operation of Aircraft in the Case of Non-Residents (SECTION 44BBA)	246
Special Provision for Computing Profits and Gains of foreign Companies Engaged in the Business of Civil Construction Etc. in Certain Turnkey Power Projects [Section 44BBB]	246
Deduction of Head Office Expenditure in the Case of Non-Residents (Section 44C)	247
Computation of Income By Way of Royalty Etc. in Case of foreign Companies (Section 44DA)	247

	<i>Page</i>
LESSON ROUND UP	261
SELF TEST QUESTIONS	261
PART IV – INCOME FROM CAPITAL GAINS	
Capital Gains	266
Capital Asset	266
Transfer	268
Distribution of Assets By Companies in Liquidation (Section 46)	273
Short-Term and Long-Term Capital Gains	273
Mode of Computation and Deductions	275
Costs with Reference to Certain Modes of Acquisition	279
Advance Money Received	283
Transfer of Securities held with Depository [Section 45(2A)]	283
Computation of Capital Gains on purchase by company of its own shares or other specified securities (w.e.f. Assessment year 2000-01)	283
Capital gains exempt from tax	283
Extension of Time for Acquiring New Asset or Depositing or investing Amount of Capital Gain (Section 54H)	291
Computation of Capital Gains in Respect of Depreciable Assets (Section 50)	292
Cost of Acquisition and Capital Gain in Case of Depreciable Assets of Electricity Companies [Section 50A]	292
Special Provisions for Computation of Capital Gains in Case of Slump Sale [Section 50B]	292
Computation of Capital Gain in Real Estate Transaction [Section 50C]	293
Fair Market Value to Be Full Value of Consideration in Certain Cases (Section 50D)	293
Reference to Valuation Officer (Section 55A)	293
Computation of Capital Gain in the Case of Conversion of Capital Asset into Stock-In-Trade [Section 45(2)]	294
Transfer of Capital Asset By A Partner to A Firm [Section 45(3)]	295
Distribution of Capital Asset on Dissolution [Section 45(4)]	295
Computation of capital gains in the case of compulsory acquisition of an asset [Section 45 (5)]	296
Computation of capital gains in the case of non-resident [First proviso to sec. 48]	296
LESSON ROUND UP	297
SELF TEST QUESTIONS	298

PART V – INCOME FROM OTHER SOURCES

Income Chargeable under the head ‘Income from Other Sources’	302
Taxation of Dividends	307

	<i>Page</i>
Deductions Allowable in Computing Income from Other Sources	311
Amounts not Deductible (Section 58)	312
Tax Concessions	312
LESSON ROUND UP	317
SELF TEST QUESTIONS	318

LESSON 5

INCOME OF OTHER PERSONS INCLUDED IN ASSESSEE'S TOTAL INCOME AND SET-OFF OR CARRY FORWARD OF LOSSES

Clubbing of Income	324
– Transfer of Income (Section 60)	324
– Revocable Transfer of Assets (Section 61)	324
– Transfer Irrevocable for A Specified Period (Section 62)	325
– Income of Spouse	325
– Income to Son's Wife [Section 64(1)(vi)]	327
– Transfer for Immediate or Deferred Benefit of Son's Wife [Section 64(1)(viii)]	327
– Income to Spouse Through A Third Person [Section 64(1)(vii)]	327
– Clubbing of Income of Minor Child [Section 64(1A)]	327
– Income from the Converted Property [Section 64(2)]	328
– Recovery of Tax	328
Set-Off and Carry-Forward of Losses	330
– Set-Off of Losses from one Source Against Income from Another Source Under the Same Head of Income [Section 70]	330
– Carry-Forward and Set-Off of Losses	331
– Carry forward and Set-Off of Accumulated Business Loss and Unabsorbed Depreciation in Certain Cases of Amalgamation or Demerger Etc.(Section 72A)	332
– Carry forward and Set off of Accumulated Loss and Unabsorbed Depreciation Allowance in Scheme of Amalgamation of Banking Company in Certain Cases (Section 72aa)	336
– Treatment of Carry-Forward of Losses of Certain Assessee	337
– Submission of Return for Loss (Section 80)	337
LESSON ROUND UP	338
SELF TEST QUESTIONS	340

LESSON 6	
DEDUCTIONS FROM GROSS TOTAL INCOME	
Introduction	344
Deduction on Life insurance Premia, Contribution to Provident Fund, Etc. (Section 80C)	344
Deduction for Contribution to Pension Fund (Section 80CCC)	347
Deduction in Respect of Contribution to Pension Scheme of Central Government [Section 80CCD]	347
Limit on Deductions Under Sections 80c, 80ccc and 80ccd (Section 80CCE)	348
Deduction in Respect of Subscription to Long Term infrastructure Bonds (Section 80CCF)	348
Deduction in Respect of investment Made Under Any Equity Saving Scheme (Section 80CCG)	348
Deduction in Respect of Medical insurance Premia (Section 80D)	349
Deduction in Respect of Maintenance including Medical Treatment of a Dependant who is a Person with Disability [Section 80DD]	349
Deduction in Respect of Medical Treatment, Etc. (Section 80ddb Read with Rule 11DD)	351
Deduction in Respect of Repayment of Loan Taken for Higher Education (Section 80E)	351
Deduction in Respect of interest on Loan Taken for Residential House Property (Section 80EE)	352
Deduction in Respect of Donations to Certain Funds, Charitable institutions, Etc. (Section 80G)	353
Deduction in Respect of Rent Paid (Section 80GG)	356
Deduction in Respect of Certain Donations for Scientific Research or Rural Development (Section 80GGA)	357
Deduction in Respect of Contributions Given by Companies to Political Parties or an Electoral Trust (Section 80GGB)	358
Deduction in Respect of Contributions Given By Any Person to Political Parties or An Electoral Trust (Section 80GGC)	358
Deduction in Respect of Profits and Gains from industrial Undertakings or Enterprise Engaged in infrastructure Development (Section 80-IA)	358
Deduction in Respect of Profit and Gains By An Undertaking A Enterprise Engaged in Development of Special Economic Zone [Section 80-IAB]	361
Deduction in Respect of Profits and Gains from Certain industrial Undertakings other Than infrastructure Development Undertakings [Section 80-IB]	361
Special Provisions in Respect of Certain Undertakings or Enterprises in Certain Special Category States [Section 80-IC]	368
Deduction in Respect of Profits and Gains from the Business of Collecting and Processing Bio-Degradable Waste (Section 80-JJA)	370
Deduction in Respect of Employment of New Workmen (Section 80-JJAA)	370
Deduction in Respect of Certain Incomes of offshore Banking Units (Section 80-LA)	371
Deduction in Respect of Income of Co-Operative Societies (Section 80P)	372

	<i>Page</i>
Deduction in Respect of Royalty Income, Etc., of Authors of Certain Books other Than Text Books (Section 80QQB)	373
Deduction in Respect of Royalty on Patents (Section 80RRB)	374
Deduction in Respect of interest on Deposits in Savings Account (Section 80TTA)	375
Deduction in Case of A Person with Disability (Section 80U)	375
Relief and Rebate in Respect of Income-Tax	376
Share of Member of An Association of Persons or Body of individuals in the Income of the Association or Body (Section 86)	376
Income from An Association of Persons or A Body of individuals (Section 86)	376
Rebate of Income-tax in case of certain individuals (Section 87A)	377
Relief When Salary is Paid in Arrears or in Advance [Section 89]	377
LESSON ROUND UP	380
SELF TEST QUESTIONS	381

LESSON 7

COMPUTATION OF TAX LIABILITY OF HINDU UNDIVIDED FAMILY / FIRM / ASSOCIATION OF PERSONS / CO-OPERATIVE SOCIETIES

Taxation of Hindu Undivided Families	386
Taxation of Firms	391
Taxation of Association of Persons	401
Taxation of Co-Operative Societies	404
Tonnage Tax Scheme [Sections 115V to 115VZC] (w.e.f. A.Y. 2005-06)	411
LESSON ROUND UP	411
SELF TEST QUESTIONS	413

LESSON 8

COMPUTATION OF TAX LIABILITY OF COMPANIES

Constitutional Provisions	418
Meaning of Company Under Section 2(17) of the Income-Tax Act	418
Categories of Companies Under the Income Tax Act, 1961	419
Tax incidence Under Income Tax Act, 1961	422
Rates of Income Tax for Assessment Year 2014-15	423
Minimum Alternate Tax (MAT)	424
Dividend Distribution Tax Under section 115-O	427
Taxation of foreign Dividends (Section 115BBD)	428

	<i>Page</i>
LESSON ROUND UP	431
SELF TEST QUESTIONS	432

LESSON 9

COMPUTATION OF TAX LIABILITY OF NON-RESIDENT ASSEESSEES

Introduction	436
Incomes Exempt in the hands of Non-Resident /Foreign Company [Section 10]	436
Special Provisions Relating to Certain Incomes of Non-Resident Indian	437
Modification in the Provisions of Computation of Capital Gains from Shares/Debentures	439
Tax on Dividends, Royalty and Technical Service Fees (Section 115A)	439
Tax on Income from Units Purchased in foreign Currency (Section 115AB)	440
Tax on Income of foreign institutional investors from Securities or Capital Gains Arising from their Transfer (Section 115AD)	440
Tax on Income from Bonds or Global Depository Receipts Purchased in foreign Currency or Capital Gains Arising from their Transfer (Section 115AC)	441
Return of Income	441
Tax on Income from Global Depository Receipts Purchased in foreign Currency or Capital Gains Arising from their Transfer (Section 115ACA)	442
Certain Incomes of Non-residents taxable in India	443
Double Taxation Relief	443
Profits of Non-Residents from Occasional Shipping Business (Section 172)	444
Special Provision for Computing Profits and Gains of the Business of Operation of Aircraft in the Case of Non-Residents (Section 44bba)	444
Deductions of Head Office Expenditure in Case of Non-Residents (Section 44c)	445
Determination of Income in Certain Cases (Rule 10)	445
Rights of an Agent	446
Incomes Escaping Assessment	447
Recovery of Tax	447
LESSON ROUND UP	447
SELF TEST QUESTIONS	448

LESSON 10

COLLECTION AND RECOVERY OF TAX

Collection and Recovery of Tax	452
Payment of Income-Tax	453

	<i>Page</i>
Deduction of Tax at Source	453
Advance Payment of Tax	467
Refunds (Sections 237 to 245)	472
Interest for Belated Payment of Income-Tax [Section 220(2)]	474
Interest for Default in Furnishing Return of Income (Section 234a)	474
Interest for Default in Payment of Advance Tax (Section 234b)	475
Interest for Deferment of Advance Tax (Section 234c)	475
Interest Receivable By the Assessee	476
LESSON ROUND UP	477
SELF TEST QUESTIONS	478

LESSON 11
PROCEDURE FOR ASSESSMENT

Income-tax Authorities (Appointment, Jurisdiction and Powers) (Section 116)	482
The Central Board of Direct Taxes (CBDT)	483
Return of Income [(Section 139(1)]	488
Return of Loss- Section 139(3)	490
Belated Return – Section 139(4)	490
Return of Income of Charitable Trust and institutions – Section 139(4a)	490
Return of Income of Political Party- Section 139(4b)	490
Return of Income of Specified Association/Institutions- Section 139(4c)	490
Revised Return- Section 139(5)	491
Defective Return-Section 139(9)	491
Signing of Return (Section 140)	493
Permanent Account Number (Section 139a)	494
Types of Assessment	495
– Self Assessment (section 140A)	495
– inquiry before assessment under section 142 or 142A	496
– Summary assessment/Intimation to the assessee u/s 143(1)	497
– Scrutiny (Regular) Assessment [Section 143(2) & (3)]	497
– Best Judgement Assessment u/s 144	498
– Income escaping Assessment or Re-assessment (section 147)	498
– Precautionary Assessment	501

	<i>Page</i>
Reference to Dispute Resolution Panel (Section 144C)	501
Rectification of Mistakes [Section 154]	503
LESSON ROUND UP	504
SELF TEST QUESTIONS	506

LESSON 12

APPEALS, REVISIONS, SETTLEMENT OF CASES AND PENALTIES & OFFENCES

Introduction	510
Appealable orders before Commissioner (Appeals) (Section 246A)	510
Revision By the Commissioner of Income Tax (Sections 263 AND 264)	514
Revision of orders prejudicial to the interest of revenue (Section 263)	514
Revision of Order in the interest of Assessee (Section 264)	516
Appellate Tribunal (Section 252)	518
Appeal to High Court	522
Appeal to the Supreme Court (Section 261)	523
Settlement of Cases [Sections 245A to 245L]	523
Defaults and Penalties	531
LESSON ROUND UP	534
SELF TEST QUESTIONS	535

LESSON 13

TAX PLANNING & TAX MANAGEMENT

Concept of Tax Planning	538
Tax Planning, Tax Avoidance and Tax Evasion	539
Objectives of Tax Planning	540
Importance of Tax Planning	542
Diversion of Income and Application of Income	542
Essentials of Tax Planning	543
Types of Tax Planning	543
Areas of Tax Planning in the Context of Income Tax Act, 1961	544
– Tax Planning Relating to Corporate Restructuring	550
– Tax Planning Relating to Financial Management Decisions	551
– Tax Planning Relating to Non-Residents	552
– Tax Planning for Indian Collaborators	553

	<i>Page</i>
– Tax Planning for Employees	554
– Tax Planning Under Wealth Tax Act	555
Charitable institutions	555
Legislative Amendments	555
Statutory force of the Notifications	556
Organisation of Tax Planning Cells	557
Overall Tax Planning Measures	558
Some General Considerations Regarding New Business	559
Setting Up and Commencement of Business Vis-A-Vis Tax Planning	560
LESSON ROUND UP	562
SELF TEST QUESTION	563

LESSON 14

WEALTH TAX ACT, 1957

Introduction	566
Chargeability	566
Definitions	566
Incidence of Wealth-Tax	567
Valuation Date [Section 2(Q)]	568
Tax Rates	569
Net Wealth [Section 2(M)]	569
Assets [Section 2(Ea)]	570
Assets Belonging to others But includable in the Net-Wealth of An individual (Deemed Assets) Section 4	572
Assets Exempt from Wealth-Tax	576
Debts and Liabilities	579
Location of Assets and Debts	580
Valuation of Assets	581
Rounding off of Net-Wealth (Section 44c)	588
Rounding off of Tax, interest, Penalty Etc. (Section 44d)	588
Return of Wealth	591
Power of Board to Dispense with Refurnishing Documents etc. with Return of Wealth (Section 14A)	593
Filing of Return in Electronic form (Section 14B)	593
Assessment	593

	<i>Page</i>
Liability to Assessment in Special Cases	598
Payment and Recovery of Wealth-Tax	601
Refunds (Section 34A)	602
Rectification of Mistakes (Section 35)	603
Settlement of Cases	604
Appeal to Commissioner (Appeals) [Section 23(1a) & (B)]	604
Appeal to the Appellate Tribunal (Section 24)	605
Revisions of Orders By Commissioner (Section 25)	606
Reference to the High Court (Sections 27)	607
Appeal to High Court (Section 27A)	608
Appeal to Supreme Court (Section 29)	608
Penalties Under the Wealth-Tax Act	608
Power to Reduce or Waive Penalty (Section 18B)	612
Offences and Prosecutions (Sections 35a to 35N)	613
LESSON ROUND UP	616
SELF TEST QUESTIONS	619

LESSON 15

BASIC CONCEPTS OF INTERNATIONAL TAXATION

An Overview of international Tax Provisions – from Indian Perspective	626
Tax Haven	627
Controlled foreign Corporation (CFC)	629
Sub Part F	629
Meaning of the Term 'Resident of Contracting State'	631
Double Taxation Relief	631
Necessity for DTAA	634
Taxation aspect of international Merger and Acquisitions	636
Transfer Pricing	639
LESSON ROUND UP	660
SUGGESTED READINGS	663

LESSON 16

ADVANCE RULING AND GAAR

Concept of Advance Ruling	666
---------------------------	-----

	<i>Page</i>
– Who Can Seek Advance Ruling?	666
– Authority for Advance Ruling	666
– Application for Advance Ruling	667
– Powers of the Advance Ruling Authority	668
– Applicability of Advance Ruling (Section 245-S)	669
– Question Precluded	669
– The Benefits of Obtaining An Advance Ruling	669
General Anti-Avoidance Rules (GAAR)	670
– GAAR in India	670
– GAAR vs. SAAR	670
LESSON ROUND UP	671
SELF TEST QUESTIONS	671

Part B : SERVICE TAX & SALES TAX

LESSON 17

BACKGROUND, ADMINISTRATION AND PROCEDURAL ASPECTS OF SERVICE TAX

Background	675
Constitutional Validity	676
Administrative Mechanism	677
Taxability of Services	678
Limbs of Service Tax Laws	678
– Meaning of Service	680
– Accounting Codes for Services	680
– Declared Services	681
– Negative List of Services	682
– List of Exemptions Under Mega Notification	684
– Place of Provision of Services Rules	696
Rate of Service Tax	700
LESSON ROUND UP	700
SELF TEST QUESTIONS	701

LESSON 18

LEVY, COLLECTION AND PAYMENT OF SERVICE TAX

Registration	704
--------------	-----

	<i>Page</i>
Payment of Service Tax	706
Incidence to Pay Service Tax	707
Due Date for Payment of Service Tax	710
Adjustment of Service Tax	711
Valuation of Taxable Services	711
Abatement in Service Tax	712
Records to be Maintained	713
Returns Under Service Tax	713
Penalties and Prosecution	714
CENVAT Credit Rules, 2004	716
Role of Company Secretaries	716
LESSON ROUND UP	717
SELF TEST QUESTIONS	718

LESSON 19

VALUE ADDED TAX – INTRODUCTION, COMPUTATION AND OTHER PROCEDURAL ASPECTS

Introduction	724
Extracts from Kelkar Committee Report	727
Vat Liability	727
Advantages	728
Methods of Computation	728
Procedure	728
Rates of Tax	729
Distinction Between Existing System and Vat	729
Registration	731
Scheme of Vat Payment	731
Exempted Sale	731
Credit and Set-Off Under Vat	732
Work Contract Tax	733
Assessment	733
VAT Audit	734
Returns	734
Zero Rating	734

	<i>Page</i>
Refunds	734
Scrutiny Process	734
Appeals, Revision and Appearances	735
Central Sales Tax	735
Goods and Service Tax	738
LESSON ROUND UP	738
SELF TEST QUESTIONS	739

LESSON 20
VAT PROVISIONS IN INDIA AND VAT SYSTEM IN OTHER COUNTRIES AND
SCOPE FOR COMPANY SECRETARIES

The Vat System	744
Legislative Provisions in Different States Relating to the Appointment, Jurisdiction and Powers of the Authorities	744
Role and Position of Company Secretaries	753
Vat in other Countries	755
LESSON ROUND UP	757
SELF TEST QUESTIONS	757

TEST PAPERS

Practice Test Papers	760
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SPECIMEN OMR ANSWER SHEET

PART A

THE INCOME TAX AND WEALTH TAX ACT

LESSONS

1. Introduction and Important Definitions
2. Basis of Charge, Scope of Total Income and Residential Status
3. Incomes which do not Form Part of Total Income
4. Computation of Total Income under Various Heads:
 - Part I – Income under head Salaries
 - Part II – Income under head House Property
 - Part III : Income From Business or Profession
 - Part IV – Income from Capital Gains
 - Part V – Income from Other Sources
5. Income of Other Persons Included in Assessee's Total Income and Set-Off or Carry Forward of Losses.
6. Deductions from Total Income
7. Computation of Tax Liability of Hindu Undivided Family/ Firm/Association of Persons/Co-operative Societies
8. Computation of Tax Liability of Companies
9. Computation of Tax Liability of Non-resident Assessee
10. Collection and Recovery of Tax
11. Procedure for Assessment
12. Appeals, Revisions, Settlement of Cases and Penalties & Offences
13. Tax Planning & Tax Management
14. Wealth Tax Act, 1956
15. Basic Concepts of International Taxation
16. Advance Ruling and GAAR

LEARNING OBJECTIVES

Tax is the financial charge imposed by the Government on income, commodity or activity. Government imposes two types of taxes namely Direct taxes and Indirect taxes. Under direct taxes, person who pays the tax bears the burden of it e.g. Income tax, Wealth Tax etc. while in Indirect taxes the person who pays the tax, shifts the burden on the person who consumes the goods or services e.g. Service tax, Value Added Tax, Excise duty etc. Here, in this part the provisions of income tax law are discussed. The first Income Tax Act in India was introduced in 1860. The present law of income tax is contained in the Income Tax Act, 1961. This act is the charging Statute of Income Tax in India. It provides for levy, administration, collection and recovery of Income Tax. The Income Tax Law comprises The Income Tax Act 1961, Income Tax Rules 1962, Notifications and Circulars issued by Central Board of Direct Taxes (CBDT), Annual Finance Acts and Judicial pronouncements by Supreme Court and High Courts.

As income tax is one of the form of direct taxes it is imposed on the income of every person whether he is a professional or non-professional. A non-professional person seeks the services of professionals to comply with provisions of Tax Laws. The profession of Company Secretaries is considered as professionals who can meet the expectations of non-professionals therefore it is expected from the students of company secretaries that they must be well equipped with the limbs tax laws including Income Tax and Wealth Tax Laws.

Lesson 1

Introduction and Important Definitions

LESSON OUTLINE

- Introduction
- Basic concepts of Income Tax Act
 - Income [Section 2(24)]
 - Capital and revenue receipts
 - Assessee [Section 2(7)]
 - Person [Section 2(31)]
 - Assessment year [section 2(9)]
 - Previous year (section 3)
- Computation of Taxable Income and Tax Liability of an Assessee
- Tax Rates
- Lesson Round Up
- Self Test Questions

LEARNING OBJECTIVES

The taxes are the basic source of revenue for the Government. Revenue raised from the taxes are utilized for meeting the expense of Government like, provision of education, infrastructure facilities such as roads, dams etc. Taxes are broadly divided into two parts i.e. direct taxes and indirect taxes. The tax that is levied directly on the income or wealth of a person is called direct tax. Income tax is one of form of direct taxes. The levy of income tax in India is governed by the Income Tax Act, 1961 and Income Tax Rules, 1962. The income tax is charged on the Total Income. To derive at the total income one must know other concepts of the Income Tax Act such as person, residential status, assessment year, previous year, assessee etc. Here, in this lesson we will discuss the various basic concepts of Income Tax Act.

At the end of this lesson, you will understand the types of taxes, meaning of taxes, know the components of income tax law, understand the various concepts like assessment year, previous year, income, person, assessee, capital and revenue receipts etc. you will also know how to compute the tax liability of a person and the applicable tax rates.

The Income Tax Department is governed by Central Board of Direct Taxes (CBDT) and it is the part of the Department of Revenue under the Ministry of Finance, Government of India.

INTRODUCTION

- Income tax is one of the form of Direct Taxes. Tax is the financial charge imposed by the Government on income, commodity or activity. Government imposes two types of taxes namely Direct taxes and Indirect taxes. Direct tax is one where burden of tax is directly on the payer e.g income tax, wealth tax etc. Indirect tax is paid by the person other than the person who utilizes the product or service e.g Excise duty, Custom duty, Service tax, Sales Tax, Value Added Tax.
- The taxes are collected for serving the primary purpose of providing sufficient revenues to the State, taxes have come to be recognised as an instrument through which the social and economic objectives of a welfare State could be achieved. They are utilized now for providing incentives for larger earnings and more savings, fostering industrial development by selective concessions, restraining ostentatious expenditure, checking inflationary pressures and achieving social objectives like inequalities and the enlargement of opportunities to the common man.
- Income-tax is one of the major sources of revenue for the Government. The responsibility for collection of income-tax vests with the Central Government. This tax is leviable and collected under Income-tax Act, 1961 (hereinafter referred to as the Act).
- The Income-tax Act, in its present form came into force on and from 1st April, 1962. Before this, the Indian Income-tax Act, 1922 was in force. The procedural matters with regard to income-tax are governed by the Income-tax Rules, 1962, its earlier counterpart being the Income-tax Rules, 1922.
- The Income tax Act contains the provisions for determination of taxable income, determination of tax liability, procedure for assessment, appeal, penalties and prosecutions. It also lays down the powers and duties of various income tax authorities.
- *Finance Act*: Every year a Budget is presented before the parliament by the Finance Minister. One of the important components of the Budget is the Finance Bill. The Bill contains various amendments such as the rates of income tax and other taxes. When the Finance Bill is approved by both the houses of parliament and receives the assent of President, it becomes the Finance Act.
- *Notifications*: The CBDT issue notifications from time to time for proper administration of the Income tax Act. These notifications become rules and collectively called Income Tax Rules, 1962.
- *Circulars*: Circulars also issued by the CBDT to clarify the doubts regarding the scope and meaning of the provisions. These provisions are issued for the guidance of the Income Tax officers and assesses. These circulars are binding on the department, not on the assessee but assessee can take benefit of these circulars.
- *Judicial Decisions*: Decisions pronounced by Supreme Court becomes law and they are binding on all the courts, Appellate Tribunal, Income Tax Authorities and on assesses while High Court decisions are binding on assesses and Income Tax Authorities which come under its jurisdiction unless it is overruled by a higher authority. The decision of a High Court can not bind other High Court.

BASIC CONCEPTS OF INCOME TAX ACT

“Income Tax is levied on the total income of the previous year of every person.”

To levy income tax, one must have the understanding of the various concepts related to the charge of tax like previous year, assessment year, Income, total income, person etc.

INCOME

No precise definition of the word 'Income' is attempted under the Income-tax Act, 1961. The definition of Income as given in Section 2(24) of the Act starts with the word includes therefore the list is inclusive not exhaustive. The definition enumerates certain items, including those which cannot ordinarily be considered as income but are treated statutorily as such. Income includes not only those things which the interpretation clause declares. It shall also include all such things the word signifies according to its natural import.

Entry 82 of List I to the Seventh Schedule of the Constitution of India confers power on Parliament to levy taxes on income other than agricultural income.

As per section 2(24), the term income means and includes :

1. *Profits and gains;*
2. *Dividend;*
3. *Voluntary contributions:* Voluntary contributions received by :
 - a trust created wholly or partly for charitable or religious purposes
 - a scientific research association; or
 - a fund or trust or institution established for charitable purposes and notified under section 10(23C)(iv) or (v) or
 - any university or other educational institution or by any hospital referred to in Section 10(23C)(iad)(vi)(iiiae)(iva); or
 - An electoral trust.
4. *The value of any perquisite or profit in lieu of salary taxable.*
5. *Any special allowance or benefit specifically granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of the duties of an office or employment of profit.*
6. *City Compensatory Allowance/ Dearness allowance:* Any allowance granted to the assessee either to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at a place where he ordinarily resides or to compensate him for the increased cost of living.
7. *Benefit or Perquisite to a Director:* The value of any benefit or perquisite, whether convertible into money or not, obtained from a company by: (a) a director, or (b) a person having substantial interest in the company, or (c) a relative of the director or of the person having substantial interest, and any sum paid by any such company in respect of any obligation which, but for such payment, would have been payable by the director or other person aforesaid;
8. *Any Benefit or perquisite to a Representative Assessee:* the value of any benefit or perquisite (whether convertible into money or not) obtained by any representative assessee under Section 160(1)(iii)/(iv) or beneficiary, or any amount paid by the representative assessee in respect of any obligation which, but for such payment, would have been payable by the beneficiary;
9. *Any sum chargeable under section 28, 41 and 59 :*
 - Any sum chargeable to tax as business income under Section 28(ii), any amount taxable in the hands of a trade, professional or similar association (for specific services performed for its members) as its income from business under Section 28(iii), and deemed profits which are taxable under Sections 41 and 59 of the Act;

- Any sum chargeable to income-tax under clause (iiia) of Section 28, i.e. profits on sale of a licence granted under the Imports (Control) Order, 1955, made under the Imports and Exports (Control) Act, 1947 [inserted by the Finance Act, 1990, with retrospective effect from 1.4.1962];
 - any sum chargeable to income-tax under clause (iiib) of Section 28 i.e., cash assistance (by whatever name called), received or receivable by any person against exports under any scheme of the Government of India.
 - any sum chargeable to income-tax under clause (iiic) of Section 28 i.e., any duty of customs or excise re-paid or re-payable as drawback to any person against exports under the Customs and Central Excise Duties Drawback Rules, 1971.
 - the value of any benefit or perquisite whether convertible into money or not; taxable as income under Section 28(iv) in the case of person carrying on business or exercising a profession;
 - any sum chargeable to income-tax under clause (v) of Section 28;
10. *Capital Gain*: Any capital gains chargeable to tax under Section 45; since the definition of income in Section 2(24) is inclusive and not exhaustive capital gains chargeable under Section 46(2) are also assessable as income.
11. *Insurance Profit*: The profits and gains of any business of insurance carried on by a mutual insurance company or by a co-operative society computed in accordance with the provisions of Section 44 or any surplus taken to be such profits and gains by virtue of the profits contained in the First Schedule to the Income-tax Act;
12. *Banking income of a Co-operative Society*: The profits and gains of any business of banking (including) providing credit facilities carried on by a cooperative society with its members.
13. *Winnings from Lottery*: Any winnings from lotteries, crossword puzzles, races, including horse-races, card-games and games of any sort or from gambling or betting of any form.
 - (i) "lottery" includes winnings, from prizes awarded to any person by draw of lots or by chance or in any other manner whatsoever, under any scheme or arrangement by whatever name called;
 - (ii) "card game and other game of any sort" includes any game show, an entertainment programme on television or electronic mode, in which people compete to win prizes or any other similar game;
14. *Employees Contribution Towards Provident Fund*: Any sum received by the assessee from his employees as contributions to any provident fund or superannuation fund or any fund set-up under the provisions of the Employees State Insurance Act, 1948 (34 of 1948) or any other fund for the welfare of such employees.
15. *Amount Received under Keyman Insurance Policy*: Any sum received under a Keyman Insurance Policy including the sum allocated by way of bonus on such policy. Keyman Insurance Policy means a life insurance policy taken by a person on the life of another person who is or was the employee of the first mentioned person or is or was connected with the business of the first mentioned person in any manner whatsoever.
16. *Amount received for not carrying out any activity*: Any sum referred to in Section 28(va), i.e. any sum, whether received or receivable in cash or kind, under an agreement for –
 - (i) not carrying out any activity in relation to any business; or
 - (ii) not sharing any know-how, patent, copyright, trade-mark, license, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision for services;
17. *Gift received for an amount exceeding ₹ 50,000*: Any sum of money or value of property referred to in clause (vii) or clause (viia) of sub-section (2) of Section 56.

18. *Consideration received for issue of shares:* Any consideration received for issue of shares as exceeds the fair market value of the shares referred in section 56(2)(viib).

Concept of Income

In general terms, Income is a periodical monetary return with some sort of regularity. However, the Income Tax Act, even certain income which does not arise regularly are treated as income for tax purposes e.g. Winnings from lotteries, crossword puzzles.

A study of some of the broad principles given below will help to understand the concept of income:

1. ***Cash or kind***

Income may be received in cash or kind. When the income is received in kind, its valuation will be made in accordance with the rules prescribed in the Income-tax Rules, 1962.

2. ***Receipt basis/ Accrual basis***

Income arises either on receipt basis or on accrual basis. It may accrue to a taxpayer without its actual receipt. The income in some cases is deemed to accrue or arise to a person without its actual accrual or receipt. Income accrues where the right to receive arises.

3. ***Legal or illegal source***

The income-tax law does not make any distinction between income accrued or arisen from a legal source and income tainted with illegality. In CIT v. Piara Singh (1980) 3 Taxman 67, the Supreme Court has held that if smuggling activity can be regarded as a business, the confiscation of currency notes by customs authorities is a loss which springs directly from the carrying on of the business and is, therefore, permissible as a deduction.

4. ***Temporary/Permanent***

There is no difference between temporary and permanent income under the Act. Even temporary income is taxable same as permanent income.

5. ***Lumpsum/instalments***

Income whether received in lump sum or in instalments is liable to tax. For example: arrears of salary or bonus received in lump sum is income and charged to tax as salary.

6. ***Gifts***

Gifts of personal nature do not constitute income subject to maximum of ₹50,000 received in cash. The recipient of gifts like birthday, marriage gifts, etc., is not liable to income-tax as received in kind however as per the Finance Act, 2009 gifts in kind having fair value upto ₹50,000 are not liable to tax but having fair value of more than ₹ 50,000 is wholly taxable.

7. ***Revenue or Capital receipt***: Income-tax, as the name implies, is a tax on income and not a tax on every item of money received. Therefore, unless the receipt in question constitutes income as distinguished from capital, it cannot be charged to tax. For this purpose, income should be distinguished from capital which gives rise to income. However, some capital receipts have been specifically included in the definition of income. The distinction between revenue or capital receipt is given below.

CAPITAL AND REVENUE RECEIPTS

An amount referable to fixed capital is a capital receipt whereas a receipt referable to circulating capital would be a revenue receipt. While the latter is chargeable to tax, the former is not subject to income-tax unless otherwise expressly provided.

Type of Capital

1. Fixed capital

Fixed capital is that which is not involved directly in the process of business but remains unaffected by the process.

2. Circulating Capital

Circulating capital is that part of the capital which is turned over in the business and which ultimately results in profit or loss. For instance, the proceeds of sale of stock-in-trade is a revenue receipt while the sale proceeds of building, machinery or plant will be capital receipt.

Type of capital will depend upon the nature of business

The very same thing may be fixed capital in the hands of one business but circulating capital in the hands of another. Machinery in the hands of a manufacturer is part of his fixed capital, whereas the same machinery with a machinery dealer is part of his circulating capital.

Nature of receipt also depends upon the reference to the recipient

Whether a particular receipt is capital or revenue in nature must be determined with reference to the recipient who is sought to be taxed as the assessee. This is essential because the character of the same amount in the hands of different persons would be different from one another since a capital asset in the hands of one person may be a trading asset in the hands of another. For tax purposes the capital or revenue character of the receipt must be determined on the basis of the nature of the trade in the course of which or in connection with which it arises.

Example

- The reimbursement of capital outlay is a capital receipt even if the total amount received exceeds the cost of the outlay itself.
- Compensation received for the loss of a capital asset is a receipt of a capital nature whereas the compensation received for damage to or loss of a trading asset is a revenue receipt.
- A capital asset is converted into income and the price realized on its sale takes form of the periodic payments of a revenue nature;
- Where a person sells his properties and the sale price is payable to him by the purchaser in the form of annuities of a fixed sum so long as the seller is alive or until he attains a particular age.

Capital and Revenue Receipts In Relation To Business Activities

Profits and gains arising from the various transactions which are entered into in the ordinary course of the business of the tax payers or those which are incidental to or closely associated with his business would be revenue receipts chargeable to tax.

Examples of these type of receipts are:

- profits on purchase and sale of shares by a share broker on his own account;
- profits arising from dealings in foreign exchange by a banker or other financial institutions,
- income from letting out buildings owned by a company to its employees etc.

But even in these cases the receipts may be of a capital nature in certain circumstances.

For instance, profit on sale of shares and securities held by a bank as investments would be of a capital nature. Where profits arise from transactions which are outside the normal dealing of the assessee, although connected with his business, the taxable nature or otherwise of the profits would depend upon the fact whether or not the transaction(s) in question constitute(s) trading activity.

Examples of differentiation between Revenue Receipts and Capital Receipts

1. Taxable income in relation to Annuities

Annuities are periodic payments of specified amounts at regular intervals of time. Annuities are revenue receipts taxable as income in every case although the payment of the annuity involves the conversion of capital into income. The contingent or variable nature of the annuity, its amount, periodicity, mode of payment etc. do not, in any way, affect the taxability of the annuity. An annuity received by an employee from his present or previous employer would be taxable as his income from salaries while all other annuities are taxable as income from other sources. Although annuities are generally annual payments, every annual payment does not represent an annuity.

For instance annual instalments of capital payments do not constitute annuities. Thus, when a person sells his business or property and agrees to receive the consideration in instalments annually or half-yearly, the amounts received by him are merely capital sums received in instalments and are, therefore, not taxable as annuities. But if the same property is sold for an annuity payable at regular intervals immediately on sale the property disappears and the right to get annuity takes place; the annuities received by virtue of the right acquired on sale would be taxable as income.

On the other hand, a lump sum payment received in commutation of salaries or pension, even though a capital receipt, would be taxable as salary income. Similarly, any amount received under a policy of insurance would be a revenue receipt if the policy was held by the assessee as a trading asset whereas it would be a capital receipt if the policy was held as a capital asset.

2. Taxable income vis-a-vis Compensation

Compensation for termination of a sole selling agency is a capital receipt although it is taxable as business income by virtue of the specific provision in Section 28 of the Act, but if an assessee has many agencies and one of them is terminated, the compensation received by the assessee would be a revenue receipt; the fact that it is taxable as business income even otherwise does not convert the character of the receipt from revenue to capital. The compensation received for restraint of trade or profession is a capital receipt since it is received in replacement of the source of income itself. But this principle does not apply to cases where the restraint of trade or profession is incidental to (and is not the primary purpose) the agreement between the parties. For instance, non-practising allowance received by a doctor from his employer as an integral part of the terms of employment would be taxable as his salary income since it does not represent a capital receipt. Therefore, the taxability of compensation in all cases would depend upon whether it is received in replacement of the main source of income itself or in replacement of the income. If it is the former, it is a capital receipt; in the latter case, it would be revenue.

3. Taxable income vis-a-vis Subsidies and grants

Subsidies and grants received from the government would generally be receipts of a revenue nature since they are intended to supplement the income of the assessee. But in cases where the grant is received for a specific purpose but not as a supplementary trading receipt it would be a capital receipt not taxable as income. For instance, if a company is given grant to undertake work to relieve unemployment or to promote family planning the grant being received for a specific purpose would constitute capital receipt exempt from tax.

4. Taxable income vis-a-vis debenture

For debenture holder the premium on redemption or the discount on issue of the debentures by the company would be a capital receipt and would not consequently be liable to tax. In the case of the issuing company also, the premium or discount on the issues of shares and debentures or on their redemptions would be on capital account. But the discount on loans advanced at a discount and repayable at a premium would be a revenue receipt in the hands of a person whose business is that of money-lending if the loans had been advanced in the ordinary course of the assessee's business without taking any extra commercial consideration as the cases. In all other cases, such a discount would be on capital account. However, the premium (salami) - a single payment made for the acquisition by the lessee of the right to occupy and enjoy the benefits granted to him under the

lease of any land, building or other capital asset is normally a capital receipt since the rights acquired or given under the lease by virtue of the payment of salary constitute a capital asset. But if the premium takes the character of advance rent (instead of the price paid for parting with and giving possession of the capital asset) the receipt would be taxable as income.

5. Taxable income vis-a-vis Royalties

Royalties in every case are taxable as income from other sources; it is immaterial whether they are received in lump sum or as fixed annual sum or otherwise; the basis of computation of the royalties would be equally immaterial. The taxability of the royalty does not also depend upon the nature of the asset the use of which gives rise to the royalty; the asset may be a patent, copyright, goodwill, technical know-how, secret formula or process and so on. If, however, the receipt is in consideration of the assignment, sale or surrender of the patent, copyright, etc. (but not the use thereof) the owner of the asset would cease to be its owner as soon as the assignment, sale or surrender takes place and therefore, the receipt would constitute a capital receipt.

6. Taxable income vis-a-vis Devaluation in foreign currency

Profit arising from devaluation of a currency or dealings in foreign exchange and that attributable to the normal fluctuations in the rate of exchange of currencies would be receipts of a revenue nature taxable as income in cases where the foreign currencies are held as stock in trade by the assessee (e.g. a bank or a dealer in the foreign exchange). Where the foreign currencies are held as capital assets representing the assessee's investments the profit or loss would be on capital account.

Exceptions where capital receipt are taxable

Although the general principle of law is to tax only revenue receipts as income, there are three exceptions to this rule under which capital receipts are also taxable as income, viz.:

- (i) Any compensation received for termination of employment or modification of the terms of employment would fall within the meaning of a profit in lieu of salary and consequently taxable as salary income. [Section 17(3)(i)]
- (ii) Any compensation received for termination of managing agency or other contractual relationship in relation to the management of whole or substantially the whole of the affairs of a company or the modification of the terms and conditions relating thereto would be taxable as income from business. [Section 28(ii)(a and b)]
- (iii) Any compensation or other payment due to or received by any person for the termination or the modification of the terms of any other agency held by him in India in relation to the business of any other person would also be taxable as income from business regardless of the nature of the agency business. [Section 28(ii)(c)].

Factors that do not determine the nature or character of receipt

The capital or revenue nature of a receipt must be determined with reference to each receipt on the basis of the facts and circumstances of each case, the ultimate conclusion as to the capital or revenue character of the receipt would be of the High Court or the Supreme Court and the principles laid down by the Court must be followed for the purpose. However, while determining the question whether a particular receipt is capital or revenue in nature, care must be taken to ensure that the following are not taken as the basis for determination although these factors may, to a certain extent, be helpful to arrive at the conclusion:

(i) Character and source of income

The nature of receipt should be decided entirely on the basis of its character in the hands of the recipient, the source from which the payment has been received being immaterial for the purpose. For instance, there may be cases where the payer makes the payment out of capital while the recipient gets it as income. This may happen in cases like the payment of interest out of capital under Section 208 of the Companies Act, 1956 which the recipient gets as income chargeable to tax. Another instance would be

of a businessman who deals in plant and machinery; while the purchaser of the machinery would pay the price out of his capital, the seller would get it as income from business. Therefore, the taxability of the receipt does not depend upon the character of payment in the hands of the payer.

(ii) Application of income

The application of the income after its receipt by the recipient is also immaterial for purposes of taxability.

(iii) Allowance or disallowance of the amount to the payer

The payment may represent expenditure in the hands of the payer and in certain cases may be disallowed in computing the taxable income of the payer. But the disallowance in the payer's hands would not in any way affect the taxability of the entire amount of remuneration in the employees or directors hands although there may be double taxation of the same amount in two hands for the same period. Thus, the allowance or disallowance of the amount to the payer is immaterial for taxing the recipient.

(iv) Treatment given in the books

The name by which the payment is called by the parties concerned and the treatment given to it in the books of accounts of the parties would also be irrelevant. For instance, every item of income from employment is taxable as salary income whether it is called salary, wages, bonus, pension, and annuity or by any other name. In other words, it is only the real character of the receipt and not what the parties call it that would determine its taxability.

(v) Magnitude and method of payment

The quantum of the payment, whether it is paid in installments or in lump sum and also whether it is paid at regular intervals of time or otherwise and even the magnitude of the payment are not the factors that determine the capital or revenue character of the receipt for tax purpose.

(vi) Basis for measurement of the receipt

The basis for measurement of the receipt (a specified percentage of the estimated profit taken as the basis for measuring damages) should not be taken as the deciding factor for determining the capital or revenue character of the receipt.

(vii) Ways or devices resorted by payer

The various devices resorted to by tax payers in arranging their financial affairs do not also conclusively establish the nature of the receipt because a tax payer is legally entitled to arrange his affairs in such a way as to reduce his tax burden to the minimum. In the light of the aforesaid principles the capital or revenue nature of the receipt should be first determined before proceeding to compute the taxable income.

Illustration:

State whether the following are capital or revenue receipts/expenses and give your reasons:

1. AB & Co. received ₹ 2,00,000 as compensation from CD & Co. for premature termination of contract of agency.
2. Sales-tax collected from the buyer of goods.
3. PQ Company Ltd. instead of receiving royalty year by year, received it in advance in lump sum.
4. An amount of ₹ 1,50,000 was spent by a company for sending its production manager abroad to study new methods of production.
5. Payment of ₹ 50,000 as compensation for cancellation of a contract for the purchase of machinery with a view to avoid an unnecessary expenditure.
6. An employee director of a company was paid ₹ 1,75,000 as a lump sum consideration for not resigning from the directorship.

Solution

- Receipt in substitution of a source of income is a capital receipt. Therefore, the amount received by AB & Co. from CD & Co. for premature termination of an agency contract is a capital receipt though the same is taxable under Section 28(ii)(c).
- Sales-tax is the liability of a seller to pay to the Government on the sale of goods made by him, which is allowed as deduction as revenue expenditure. If any part of Sales-tax is collected from the buyer of goods that may be treated as a revenue receipt. Thus the sales-tax collected from the buyer of goods is a revenue receipt.
- Receipt of lump sum royalty in lieu of future royalties is a revenue receipt, as it is an income from royalty.
- Amount spent by a company for sending its production manager abroad to study new methods of production is a revenue expenditure to be allowed as a deduction. Because the new knowledge and exposure of that manager will assist the company in improving its existing methods of production etc.
- This is a capital expenditure, as any expenditure incurred by a person to free himself from a capital liability is a capital expenditure. In the given case, the payment of ₹ 50,000 for cancelling the order for purchase of the machinery, has helped the assessee to become free from an unnecessary capital liability.
- The amount of ₹ 1,75,000 received for not resigning from the directorship is a reward received from the employer. Therefore it is a revenue receipt.

ASSESSEE

In common parlance every tax payer is an assessee. However, the word assessee has been defined in Section 2(7) of the Act according to which assessee means a person by whom any tax or any other sum of money (i.e. interest, penalty etc.) is payable under the Act and includes:

- every person in respect of whom any proceeding under this Act has been taken for the assessment of his income or assessment of fringe benefits or of the income of any other person in respect of which he is assessable or to determine the loss sustained by him or by such other person or to determine the amount of refund due to him or to such other person.
- every person who is deemed to be an assessee under any provision of this Act.
- every person who is deemed to be an assessee in default under any provision of this Act.

Accordingly, assessee is a person by whom tax or any other sum is payable under the Act.

The expression "other sum of money" includes

- fine, interest, penalty and tax or
- person to whom any refund of tax etc. is due under the Act or
- if any proceeding under the Act has been taken against any person, he is also an assessee. Remember, the proceedings must be initiated under the provisions of the Act. In other words, a single enquiry letter issued by the Income-tax Department without reference to any specific provision of the Act does not constitute proceeding under the Act and, as such, till proceedings are initiated under the Act, the person may not become an assessee within the ambit of Section 2(7) of the Act.

Test Your Knowledge

- Gifts received in kind are not taxable subject to a fair value maximum of
- Circulars are binding on Income Tax Authorities as well as assessees. True or False.

PERSON [SECTION 2(31)]

Income-tax is charged in respect of the total income of the previous year of every person. Hence, it is important to know the definition of the word person. As per section 2(31), Person includes:

- an individual;
- a Hindu undivided family;
- a company
- a firm
- an association of persons or a body of individuals whether incorporated or not;
- a local authority;

every artificial, juridical person, not falling within any of the above categories

An individual

a natural human being, i.e. male, female, minor or a person of sound or unsound mind.

A Hindu undivided family

it consists of all persons lineally descended from a common ancestor and includes their wives and unmarried daughters.

Note: For details refer the chapter on Assessment of Hindu Undivided Families.

A company

Section 2(17) defines the term 'company' to mean:

- (i) any Indian company, or
- (ii) any body corporate incorporated by or under the laws of a country outside India i.e. a foreign company, or
- (iii) any institution, association or body which is or was assessable or was assessed as a company for any assessment year under the Indian Income Tax Act, 1922 or which is or was assessable or was assessed under this Act as a company for any assessment year commencing on or before the 1st day of April, 1970, or
- (iv) any institution, association or body, whether incorporated or not and whether Indian or non-Indian, which is declared by general or special order of the Board to be a company only for such assessment year or assessment years (whether commencing before the first day of April, 1971 or, on or after that date), as may be specified in the declaration.

Section 2(17) defines the term 'company' to mean:

- (i) any Indian company, or
- (ii) any body corporate incorporated by or under the laws of a country outside India i.e. a foreign company, or
- (iii) any institution, association or body which is or was assessable or was assessed as a company for any assessment year under the Indian Income Tax Act, 1922 or which is or was assessable or was assessed under this Act as a company for any assessment year commencing on or before the 1st day of April, 1970, or

- (iv) any institution, association or body, whether incorporated or not and whether Indian or non-Indian, which is declared by general or special order of the Board to be a company only for such assessment year or assessment years (whether commencing before the first day of April, 1971 or, on or after that date), as may be specified in the declaration.

A firm

a partnership firm whether registered or not.

An association of persons or a body of individuals whether incorporated or not

The difference between Association of persons and body of individuals is that whereas an association implies a voluntary getting together for a definite purpose, a body of individuals would be just a body without an intention to get-together. Moreover, the members of body of individuals can be individuals only whereas the members of an association of persons can be individual or non-individuals (i.e. artificial persons).

A local authority

means a municipal committee, district board, body of port commissioners, or other authority legally entitled to or entrusted by the Government with the control and management of a Municipal or local fund.

Every artificial, juridical person, not falling within any of the above categories:

This is a residuary clause. If the assessee does not fall in any of the first six categories, he is assessed under this clause. Generally, a statutory corporation, deity or charitable institution or an endowment for charitable or religious purposes falls under artificial juridical person.

ASSESSMENT YEAR [SECTION 2(9)]

“Assessment year” means the period of twelve months commencing on 1st April every year and ending on 31st March of the next year. Income of previous year of an assessee is taxed during the following assessment year at the rates prescribed by the relevant Finance Act.

PREVIOUS YEAR (SECTION 3)

Income earned in a year is taxable in the next year. The year in which income is earned is known as previous year. From the assessment year 1989-90 onwards, all assessees are required to follow financial year (i.e. April 1 to March 31) as previous year. The uniform previous year has to be followed for all sources of income.

In case of newly set up business or profession or a source of income newly coming into existence, the first previous year will be the period commencing from the date of setting up of business/profession or as the case may be, the date on which the source of income newly comes into existence and ending on the immediately following March, 31.

Examples of previous year in the case of newly set-up business/profession:

Example 1

Y sets up a new business on May 15, 2013. What is the previous year for the assessment year 2014-15.

Ans. Previous year for the assessment year 2014-15 is the period commencing on May 15, 2013 and ending on March 31, 2014.

Example 2

A joins an Indian company on February 17, 2013. Prior to joining this Indian company he was not in employment nor does he have any other source of income. Determine the previous year of A for the assessment years 2013-14 and 2014-15.

Ans. Previous years for the assessment years 2013-14 and 2014-15 will be as follows:

Previous year	Assessment year
Feb. 17, 2013 to March 31, 2013	2013-14
April 1, 2013 to March 31, 2014	2014-15

COMPUTATION OF TAXABLE INCOME AND TAX LIABILITY OF AN ASSESSEE

Income tax is a charge on the assessee's income. Income Tax law lays down the provisions for computing the taxable income on which tax is to be charged. Taxable income of an assessee shall be calculated in the following manner:

1. Determine the residential status of the person as per section 6 of the Act.
2. Calculate the income as per the provisions of respective heads of income. Section 14 classifies the income under five heads:
 - (i) Income from salaries
 - (ii) Income from House Property
 - (iii) Profits and gains of business or Profession
 - (iv) Capital Gains
 - (v) Income from other sources
3. Consider all the deductions and allowances given under the respective heads before arriving at the net income.
4. Exclude the income exempt under section 10 of the Act.
5. Aggregate of incomes computed under the 5 heads of income after applying clubbing provisions and making adjustments of set off and carry forward of losses is known as Gross Total Income.
6. Deduct therefrom the deductions admissible under Sections 80C to 80U. The balance is called Total income. The total income is rounded off to the nearest multiple of Rupees ten. (Section 288A)
7. Add agriculture income in the total income calculated in (6) above. Then calculate tax on the aggregate as if such aggregate income is the Total Income.
8. Calculate income tax on the net agricultural income as increased by ₹ 2,00,000/2,50,000/5,00,000 as the case may be, as if such increased net agricultural income were the total income.
9. The amount of income tax determined under (8) above will be deducted from the amount of income tax determined under (7) above.
10. Calculate income tax on capital gains under Section 112, and on other income at specified rates.
11. The balance of amount of income tax left as per (9) above plus the amount of income tax at (10) above will be the income tax in respect of the total income.
12. Deduct the following from the amount of tax calculated under (11) above:
 - Tax deducted and collected at source.
 - Advance tax paid.
 - Double taxation relief.
13. The balance of amount left after deduction of items given in (12) above, shall be the net tax payable or net tax refundable for the assessee. Net tax payable/refundable shall be rounded off to the nearest multiple of Ten rupees (Section 288B).
14. Along with the amount of net tax payable, the assessee shall have to pay penalties or fines, if any, imposed on him under the Income-tax Act.

TAX RATES**(A) For any individual (resident or non-resident), every HUF/AOP//BOI/artificial juridical person**

Total Income From All Sources Except Incomes Taxable at Specified Rates (after All Permissible Deduction)	Income Tax Rates
Upto 2,00,000	NIL
₹ 2,00,001 to ₹ 5,00,000	10%
₹ 5,00,001 to ₹10,00,000	20%
Above ₹ 10,00,000	30%
For resident senior citizen (who is of 60 years but less than 80 years during the previous year)	
Upto ₹ 2,50,000	NIL
₹ 2,50,001 to ₹ 5,00,000	10%
₹ 5,00,001 to ₹ 10,00,000	20%
Above ₹ 10,00,000	30%
For resident senior citizen (who is of 80 years during the previous year)	
Upto ₹ 5,00,000	NIL
₹ 5,00,001 to ₹ 10,00,000	20%
Above ₹ 10,00,000	30%

(B) Firms/LLP: A firm/LLP is taxable at the rate 30%.

(C) Companies: Domestic Company @ 30% and Foreign Company @40% and 50% in case of certain specific incomes.

(D) Cooperative Society

Upto ₹ 10,000	10%
₹ 10,001 to ₹ 20,000	20%
Above ₹ 20,000	30%

(E) Surcharge

– **On Individual, HUF, Firm, local authority, AOP, BOI and Co-operative Society**

The amount of income-tax computed for Individual, HUF, Firm, local authority, AOP, BOI and Co-operative Society shall be increased by a surcharge @10% of such income-tax where, the total income exceeds 1 crore rupees .

– **On Domestic company**

The surcharge @ 5% in case of a domestic company shall be levied if the total income of the domestic company exceeds 1 crore rupees but does not exceed 10 crore rupees and the surcharge @ 10% shall be levied if the total income of the domestic company exceeds 10 crore rupees.

– ***On companies other than domestic companies***

In case of companies other than domestic companies, the surcharge of 2 % shall be levied if the total income exceeds 1 crore rupees but does not exceed 10 crore rupees and surcharge @5% shall be levied if the total income exceeds 10 crore rupees.

(F) Education Cess and Secondary Higher Education Cess

The amount of income-tax as computed including surcharge thereon shall be increased by an Education Cess on Income Tax by 2% for the purpose of fulfilling the commitment of the Central Government to provide and finance universalized basic education and 1% Secondary and Higher Education Cess shall also be charged @ 1%

(G) Alternate minimum Tax

From Assessment Year 2013-14, tax payable by a person other than a company shall not be less than 18.5% plus education cess plus secondary & higher education cess of “Adjusted Total Income” as per section 115JC.

LESSON ROUND UP

- Income tax is one of the form of Direct Taxes. Tax is the financial charge imposed by the Government on income, commodity or activity. Government imposes two types of taxes namely Direct taxes and Indirect taxes. Direct tax is one where burden of tax is directly on the payer e.g. income tax, wealth tax etc. Indirect tax is paid by the person other than the person who utilizes the product or service e.g. Excise duty, Custom duty, Service tax, Sales Tax, Value Added Tax.
- The Income tax Act contains the provisions for determination of taxable income, determination of tax liability, procedure for assessment, appeal, penalties and prosecutions.
- Every year a Budget is presented before the parliament by the Finance Minister. One of the important components of the Budget is the Finance Bill. The Bill contains various amendments such as the rates of income tax and other taxes. When the Finance Bill is approved by both the houses of parliament and receives the assent of President, it becomes the Finance Act.
- To levy income tax, one must have the understanding of the various concepts related to the charge of tax like previous year, assessment year, Income, total income, person etc.
- **Income:** No precise definition of the word ‘Income’ is attempted under the Income-tax Act, 1961. The definition of Income as given in Section 2(24) of the Act starts with the word includes therefore the list is inclusive not exhaustive.
- **Assessee:** In common parlance every tax payer is an assessee. However, the word assessee has been defined in Section 2(7) of the Act according to which assessee means a person by whom any tax or any other sum of money (i.e. interest, penalty etc.) is payable under the Act
- **Person:** Income-tax is charged in respect of the total income of the previous year of every person. Hence, it is important to know the definition of the word person.
- “**Assessment year**” means the period of twelve months commencing on 1st April every year and ending on 31st March of the next year.
- **Previous year:** Income earned in a year is taxable in the next year. The year in which income is earned is known as previous year.
- **Computation of income:** Income tax is a charge on the assessee’s income. Income Tax law lays down the provisions for computing the taxable income on which tax is to be charged.

SELF TEST QUESTIONS

These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation.

1. The basic exemption limit in case of a non-resident individual being a senior citizen is:

- (a) ₹ 1,80,000
- (b) ₹ 2,40,000
- (c) ₹ 2,50,000
- (d) ₹ 2,00,000

2. Which of the following is not an example of capital receipt:

- (a) Money received on issue of shares
- (b) Money received on sale of land
- (c) Money received on sale of goods
- (d) None of the above

3. The amount of educations cess and secondary and higher education cess to be collected along with Income tax for assessment year 2014-15 shall be

- (a) 1%
- (b) 2%
- (c) 3%
- (d) 4%

4. Income tax in India is charged at the rate prescribed by :

- (a) The Finance Act
- (b) The Income Tax Act
- (c) The Central Board of Direct Taxes
- (d) the Ministry of Finance

5. The term 'income' includes the following types of incomes:

- (a) Legal
- (b) Illegal
- (c) Legal and illegal both
- (d) None of the above

6. Which of the following income is not included in the term 'income' under the Income Tax Act, 1961:-

- (a) Profits and gains
- (b) Profit in lieu of salary
- (c) Dividend

- (d) Reimbursement of travelling expenses.

FILL IN THE BLANKS

1. Compensation received for the loss of a capital asset is a receipt of a _____ nature
2. _____ is levied on the total income of the previous year of every person.
3. Aggregate of incomes computed under the 5 heads of income after applying clubbing provisions and making adjustments of set off and carry forward of losses is known as _____.
4. The year in which income is earned is known as _____.
5. _____ are binding on the department, not on the assessee but assessee can take benefit of these circulars
6. Income of a business commenced on 1st March, 2014 will be assessed during the assessment year _____.

SHORT NOTES

1. Tax Rates
2. Assessee
3. Hindu Undivided Family

DISTINGUISH BETWEEN

1. Capital Receipt and Revenue Receipt
3. Assessment Year and Previous year
4. Slab Rate and Fixed rate
5. Total Income and Gross Total Income

PRACTICAL QUESTION

1. State, with reasons in brief, whether the following are capital or revenue receipts/expenditure :
 - (i) ₹ 20,000 spent in connection with obtaining a licence for running a cinema hall.
 - (ii) ₹ 3,00,000 received as compensation for termination of contract of agency.
 - (iii) Lump sum received as advance rent.
 - (iv) Overhaul expenses of second hand machinery.
 - (v) Payment to an employee to retain him in job.

ELABORATIVE QUESTIONS

1. 'Every assessee is a person, but every person need not be an assessee'. Critically examine the statement with reference to the relevant definitions under the provisions of the Income Tax Act, 1951.
2. "Income tax is a tax on income and not a tax on every item of money received." Explain this statement with reference to capital and revenue receipts.

ANSWERS/HINTS

Multiple Choice Question

1. (d); 2. (c); 3. (c); 4. (a); 5. (c); 6. (d)

Fill in the Blanks

- ## 1. Capital 2. Income Tax 3. Gross Total Income 4. Previous Year 5. Circulars 6. 2014-15

Test Your Knowledge

1. ₹ 50,000 2. False

SUGGESTED READINGS

1. Dr. V.K. Singhania : Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.

2. Girish Ahuja and Ravi Gupta : Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.

Lesson 2

Basis of Charge, Scope of Total Income and Residential Status

LESSON OUTLINE

- Residential Status and Tax Liability (Section 6)
 - Test for residence of individuals
 - Test for residence of HUF, Firms and other Associations of Persons
 - Test for residence of companies
- Charge of Income Tax (Section 4)
- Meaning and Scope of total Income (Section 5)
 - Scope of total income has been defined on the basis of residential status
 - Income received
 - Income deemed to be received
 - Income accrued
 - Income deemed to accrue or arise in India
- Appportionment of Income between spouses governed by Portuguese Civil Code (Section 5A)
- Tax incident vis-a-vis residential status
- Lesson Round Up
- Self Test Questions

LEARNING OBJECTIVES

Income tax is levied on the taxable income of every person. For calculation of income tax, taxable income is the basis. To determine taxable income, residential status of the person and scope of total income are the initial steps. There are two types of taxpayers from residential point of view – Resident in India and Non-resident in India. Indian income is taxable in India whether the person earning income is resident or non-resident. Conversely, foreign income of a person is taxable in India only if such person is resident in India. Foreign income of a non-resident is not taxable in India. Therefore, the determination of the residential status of a person is very significant in order to find out his tax liability.

The basis for determination of residential status vary person wise. For instance, residential status of individual and HUF depend upon the stay in India, for corporate the residential status is determined on the basis of control and management of its affairs situated in India or not.

At the end of this Lesson, you will –

- Able to determine the residential status of a person
- Be aware of the importance of residential status for tax purposes
- Understand the scope of total income.

The residential status of the assessee is to be determined each year with reference to the “previous year”. The residential status of the assessee may change from year to year. What is essential is the status during the previous year and not in the assessment year. Moreover, the concept of residential status is nothing to do with nationality or domestic of a person. An Indian, who is a citizen of India, can be non-resident for Income Tax purposes, whereas a foreigner can be resident of India for Income Tax purpose.

RESIDENTIAL STATUS AND TAX LIABILITY (SECTION 6)

Total income of an assessee cannot be computed unless the person's residential status in India during the previous year is known. According to the residential status, the assessee can either be;

- (i) Resident in India or
- (ii) Non-resident in India

However, individual and HUF cannot be simply called resident in India. If individual or HUF is a resident in India, they will be either;

- (a) Resident and Ordinarily resident in India (ROR) or
- (b) Resident but not Ordinarily resident in India (RNOR).

In case of persons other than individual and HUF, he will be either resident in India or non-resident in India.

Section 6 of the Income-tax Act prescribes the tests to be applied to determine the residential status of all tax payers for purposes of income-tax. There are three alternative tests to be applied for individuals, two for companies and Hindu Undivided Families and firms, associations of persons, bodies of individuals and artificial juridical persons.

An assessee's residential status must be determined with reference to the previous year in respect of which the income is sought to be taxed (and not with reference to the assessment year).

TEST FOR RESIDENCE OF INDIVIDUALS

An individual may either be a

- (i) Resident in India or
- (ii) Non-resident in India

However, individual cannot be simply called resident in India. If individual is a resident in India he will be either;

- (a) Resident and Ordinarily resident in India (ROR) or
- (b) Resident but not Ordinarily resident in India (RNOR).

Basic Condition for a person to be Resident

Under Section 6(1) of the Income-tax Act, an individual is said to be resident in India in any previous year if he:

- (a) is in India in the previous year for a period or periods amounting in all to one hundred and eighty-two days or more i.e., he has been in India for at least 182 days during the previous year; or,
- (b) has been in India for at least three hundred and sixty-five days (365 days) during the four years preceding the previous year and has been in India for at least sixty days (60 days) during the previous year except in following cases; where if condition (a) is satisfied then an individual is resident otherwise he will be Non-Resident.
 - Citizen of India, who leaves India in any previous year as a member of the crew of an Indian ship, or for the purpose of employment outside India, or
 - Citizen of India or Person of Indian origin engaged outside India (whether for rendering service outside or not) and who comes on a visit to India in the any previous year.

Therefore, in case of India Citizen being crew member of an Indian Ship, India Citizen going abroad for employment purpose (other than training) or Indian Citizen/Person of Indian Origin coming on a visit to India during relevant previous years. Then condition (a) only needs to be checked. If it is satisfied, then individual is treated as resident, otherwise he will be treated as non resident.

A person is deemed to be of Indian origin if he, or either of his parents or any of his grandparents, was born in Undivided India. It may be noted that grandparents include both maternal and paternal grand parents

Non-Resident

If an individual does not satisfy any of the above basic condition then, he will be treated as Non-Resident.

It must be noted that the fulfillment of any one of the above conditions (a) or (b) will make an individual resident in India for tax purposes since both these conditions are alternative and not cumulative in their application

Additional Conditions for a person to be resident and ordinary resident (ROR)

An individual may become a resident and ordinarily resident in India if he has satisfy both the following conditions given u/s 6(1)besides satisfying any one of the above mentioned conditions:

- (i) he is a resident in atleast any two out of the ten previous years immediately preceding the relevant previous year, and
- (ii) he has been in India for 730 days or more during the seven previous years immediately preceding the relevant previous year.

Resident and not ordinary resident (RNOR)

An individual is not ordinarily resident in any previous year if he has been a non-resident in India in at least nine out of the ten previous years preceding that previous year, or has during the seven previous years preceding that previous year been in India for a period of, or periods amounting in all to, seven hundred and twenty-nine days (729 days) or less. In other words, if resident individual is not able to satisfy both the additional conditions, then he will be resident but not ordinary resident (RNOR).

Important Points

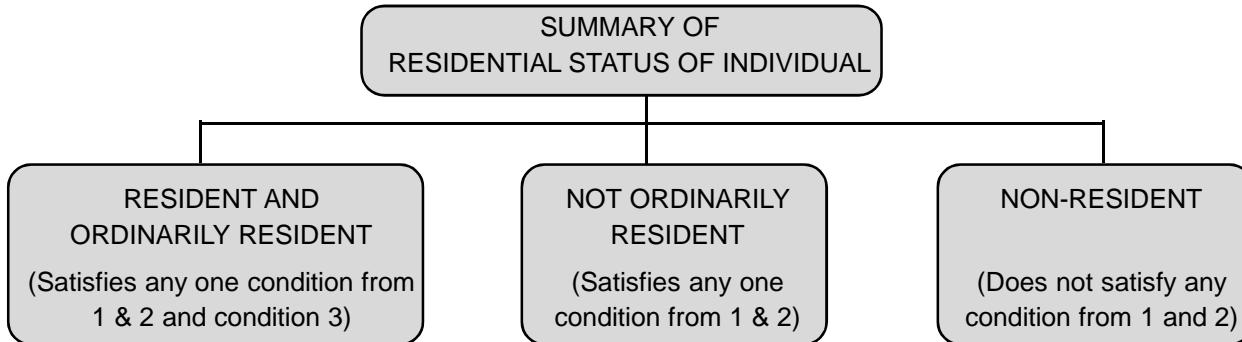
- (i) The fact that an assessee is resident in India in respect of one year does not automatically mean that he would be resident in the preceding or succeeding years as well. Consequently, the residential status of the assessee should be determined for each year separately. This is in view of the fact that a person resident in one year may become non-resident or not ordinarily resident in another year and vice versa.
- (ii) It must also be noted that the residential status of an individual for tax purposes is neither based upon nor determined by his citizenship, nationality and place of birth or domicile. This is because of the fact that, for tax purposes, an individual may be resident in more than one country in respect of the same year.
- (iii) The common feature in both the above conditions is the stay of the individual in India for a specified period. The period of stay required in each of the conditions need not necessarily be continuous or consecutive nor it is stipulated that the stay should be at the usual place of residence, business or employment of the individual. Purpose of stay is immaterial in determining the residential status.
- (iv) The stay may be anywhere in India and for any length of time at each place in cases where the stay in India is at more places than one, what is required is the total period of stay should not be less than the number of days specified in each condition.

(v) Steps to solve residential status of an Individual:

- *Step 1:* Determine whether the person falls under exception to basic condition;
- *Step 2:* If yes, apply only first basic condition, if satisfied, then he will be resident otherwise non-resident. If no, then apply both basic conditions and Individual becomes Resident on satisfaction of any one condition.
- *Step 3:* Resident Individual will be called ROR if satisfies both the additional conditions, otherwise he will be called RNOR.

(vi) India means territory of India, its territorial waters, continental shelf, Exclusive Economic Zone (upto 200 nautical miles) and airspace above its territory and territorial waters.

(vii) Where the exact arrival and departure time is not available then the day he comes to India and the day he leaves India is counted as stay in India.



Condition 1: If individual is in India in the previous year for a total period of 182 days or more.

Condition 2: If he has been in India for at least 365 days during the 4 years preceding the previous year and has been in India for at least 60 days during the previous year. However this clause will not be applicable if he is a:

- Citizen of India, who leaves India in any previous year as a member of the crew of an Indian ship, or for the purpose of employment outside India or
- Citizen of India or of Indian origin engaged outside India (whether for rendering service outside or not) and who comes on a visit to India in the any previous year.

Condition 3: An individual who has been a non-resident in India in at least nine out of the ten previous years preceding that year, and has during the seven previous years preceding that year been in India for a period of, or periods amounting in all to 729 days or less.

Illustration 1

Mr. P, an Indian Citizen, is living in Delhi since 1960, left for Japan on July 1, 2009. He comes back on August 7, 2013. Determine his residential status for the assessment year 2014-15.

Solution:

Stay in India for a minimum period of 182 days in the previous year:

Mr. P has stayed in India for 236 (viz. $24 + 30 + 31 + 30 + 31 + 31 + 28 + 31$) days in the previous year 2013-14. So, this test is satisfied.

So, Mr. P shall be a resident in India during the previous year 2013-14. (Assessment year 2014-15).

Keeping in view the facts of the given case, Mr. P satisfies the two additional conditions also namely:

- He is resident in two out of ten previous years preceding the relevant previous year.

PY	Stay in PY (days)	Stay during 4 PY (days)	Basic Condition Satisfied	Resident/Non- Resident
2012-13	Nil	–	None	Non-Resident
2011-12	Nil	–	None	Non-Resident
2010-11	Nil	–	None	Non-Resident
2009-10	$30+31+30+1= 92$	= 366 days	Second	Resident
2008-07	365	–	First	Resident

- His stay in India is also more than 730 days in 7 previous years preceding the relevant previous year. As he left for Japan on 1st July 2009.

PY	Stay (days)
2012-13	Nil
2011-12	Nil
2010-11	Nil
2009-10	92
2008-09	366
2007-08	365
2006-07	365
Total Stay in 7 Previous Years	1188

Hence, Mr. P is resident and ordinary resident in India for the assessment year 2014-15.

Illustration 2

Dr. Q, an Indian Citizen and a Professor in IIM, Lucknow, left India on September 15, 2013 for USA to take up Professor's job in MIT, USA. Determine his residential status for the assessment year 2014-15.

Solution:

Dr. Q being a citizen of India and who has gone out of the country for employment, will be governed by 182 days test only and therefore the second condition under section 6(1), i.e. 60 days during relevant previous year and 365 days during the four previous year immediately preceding relevant previous year shall not be applicable.

Dr. Q stay in India for 168 (viz. 30 + 31 + 30 + 31 + 31 + 15) days only in the relevant previous year.

Hence, Dr. Q shall be a non-resident in India for the assessment year 2014-15 as condition by stay of 182 days in relevant previous year is not satisfied.

Illustration 3

Mr. R is a foreign citizen. Determine his residential status for the assessment year 2014-15 on the assumption that during financial years 1999-00 to 2013-14, he was present in India as follows:

P.Y	Days	P.Y.	Days
2013-2014	185 days	2005-2006	300 days
2012-2013	85 days	2004-2005	150 days
2011-2012	275 days	2003-2004	200 days
2010-2011	75 days	2002-2003	180 days
2009-2010	200 days	2001-2002	20 days
2008-2009	90 days	2000-2001	40 days
2007-2008	150 days	1999-2000	300 days
2006-2007	30 days		

Solution :

The facts of the given case may be presented in the form of the following table:

Year	Presence in India
2013-2014	185
2012-2013	85
2011-2012	275
2010-2011	75
2009-2010	200
2008-2009	90
2007-2008	150
2006-2007	30
2005-2006	300
2004-2005	150
2003-2004	200
2002-2003	180
2001-2002	20
2000-2001	40
1999-2000	300

The following facts are now available:

- (i) Stay of Mr. R during the previous year 2013-14 is 185 days.
- (ii) Mr. R is resident in India in two out of ten previous years preceding the relevant previous year (viz. resident in 2012-13 on satisfaction of 2nd Basic Condition and resident in 2011-12 on satisfaction of 1st Basic Condition).
- (iii) Stay of Mr. R in India is also more than 730 days in 7 previous years preceding the relevant previous year.

Hence, Mr. R shall be a resident and ordinary resident for the assessment year 2014-15.

Illustration 4

Mr. A is a foreign citizen. His father was born in Delhi in 1954 and mother was born in England in 1960. His grandfather was born in Delhi in 1932. Mr. A is coming to India to see Taj Mahal and visit other historical places in India. He comes to India on 1st November, 2013 for 200 days. He has never come to India before. Determine his residential status for AY 2014-15.

Solution:

Mr. A falls in exception to basic conditions as he is a Person of Indian Origin (as his grandfather was born in undivided India) and he comes on a visit to India during relevant Previous year. Therefore, only first basic condition of 182 days during relevant previous year would be checked.

Stay during relevant PY 2013-14 = 1st Nov, 2013 to 31st March, 2014 = 30+31+31+28+31 = 151 days

Mr. A is Non-resident in India for PY 2013-14 as he does not satisfy first basic condition.

TESTS OF RESIDENCE FOR HINDU UNDIVIDED FAMILIES, FIRMS AND OTHER ASSOCIATIONS OF PERSONS

The test to be applied to determine the residential status of a HUF, Firm or other Association of Persons is based upon the control and management of the affairs of the assessee concerned. The tests based on the period of stay in India applicable to individuals cannot be applied to these assessees for obvious reasons.

Meaning of place of control and management:

The expression control and management refers to the functions of decision-making and issuing directions but not the places where from the business is carried on.

In other words, the Control and Management means taking policy decisions relating to business. Policy decisions are concerning finance, marketing, production, advertising, personnel etc. It does not mean day to day operations of the concern/assessee. The control and management is situated at that place where policy decisions are taken.

- Control and Management of HUF: It is with Karta or its Manager.
- Control and Management of Firm/AOP: It is with Partners/Members.
- Control and Management of Company: It is with Board of Directors. It can be said that Control and Management of Company is situated at a place where Board meetings are held.

A HUF, firm or other association of persons is said to be resident in India within the meaning of Section 6(2) in any previous year, if during that year the control and management of its affairs is situated wholly or partly in India. If the control and management of its affairs is situated wholly outside India during the relevant previous year, it is considered non resident.

A HUF can be “not ordinarily resident”

If manager/karta has been a not ordinarily resident in India in the previous year in accordance with the tests applicable to individuals. Where, during the last ten years the kartas of the H.U.F. had been different from one another, the total period of stay of successive kartas of the same family should be aggregated to determine the residential status of the karta and consequently the H.U.F.

In other words, if Karta of Resident HUF satisfies both the following additional conditions (as applicable in case of Individual) then Resident HUF will be ROR, otherwise it will be RNOR:

Additional Conditions :

- (1) Karta of Resident HUF should be resident in atleast 2 previous years out of 10 previous year immediately preceding relevant previous year.
- (2) Stay of Karta during 7 previous year immediately preceding relevant previous year should be 730 days or more.

Note:

It is immaterial whether Karta is Resident or Non-Resident during relevant previous year, for the purpose of determining whether HUF is ROR or RNOR. If Karta satisfies both the additional conditions, then HUF will be ROR, otherwise RNOR.

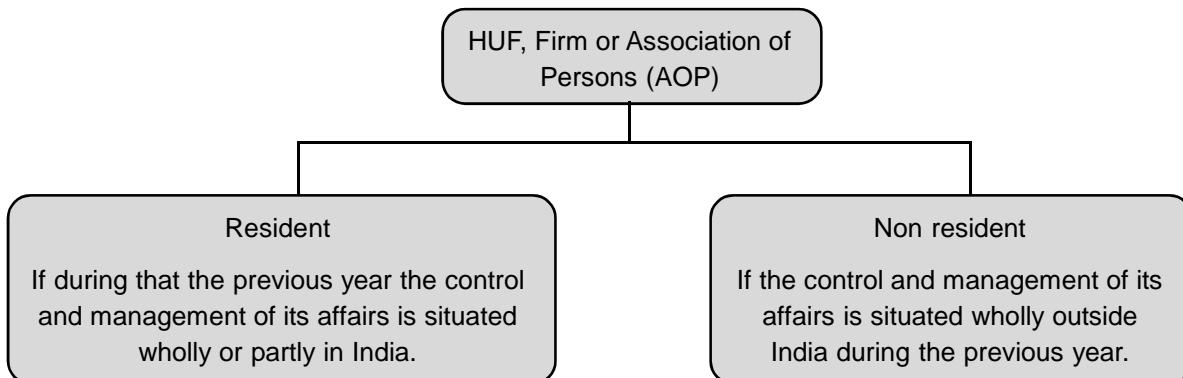
Firms, association of persons, local authorities and other artificial juridical persons can be either resident (ordinarily resident) or non-resident in India but they cannot be not ordinarily resident in India.

IMPORTANT POINTS

- Even if negligible portion of the control and management of the affairs is exercised from India, it will be

sufficient to make the family, firm or the association resident in India for tax purposes. For instance, if the affairs of a firm are controlled partly from India and partly from Bangladesh, the firm would be resident both in India.

- While the control and management of the affairs of the firm or family would necessarily be exercised by the partners of the firm or members of the family, the residential status of the members or partners is generally irrelevant for determining the residential status of the firm or family. But in cases where the residential status of the partners materially affects or determines the place of control and management of the affairs of the firm, the residential status of the member or partners should also be taken into account in determining the residential status of the firm or the family.
- The mere fact that all the partners are resident in India does not necessarily lead to the conclusion that the firm is resident in India because there may be cases where even though the partners are resident in India, control and management of the affairs of the firm is exercised from outside India.
- A Hindu Undivided Family would generally be presumed to be resident in India unless the assessee proves to the tax authorities that the control and management of its affairs is situated wholly outside India during the relevant accounting year.



A Resident HUF would be either ROR if karta of HUF also satisfies both the additional condition. Otherwise HUF would be RNOR.

Illustration 1

ABC HUF's whole affairs of business are completely controlled from India. Determine its Residential status for AY 2014-15 (a) if Karta is ROR in India for that year (b) If Karta is NR in India but he satisfies both the additional conditions (c) If Karta is RNOR in India.

Solution:

HUF would be Resident in India as Control and Management is wholly situated in India. Determination of whether HUF is ROR or RNOR:

- (a) HUF is ROR in India as Karta would be satisfying both the additional conditions (because he is ROR).
- (b) HUF is ROR in India as Karta is satisfying both the additional conditions. Karta's residential status during relevant previous year (i.e. resident/non-resident) is irrelevant.
- (c) HUF is RNOR as Karta does not satisfy both the additional conditions.

Illustration 2

XY & Co. is a partnership firm whose operations are carried out in India. However, all meetings of partners take place outside India as all the partners are settled abroad. Determine Residential status of firm for AY 2014-15.

Solution:

XY & Co. is Non-Resident in India during relevant previous year as Control and Management (place where policy decisions are taken, here it is the place where meetings are held) is wholly situated outside India.

TESTS OF RESIDENCE FOR COMPANIES

All Indian companies within the meaning of Section 2(26) of the Act are always resident in India regardless of the place of control and management of its affairs.

In the case of a foreign company the place of control and management of the affairs is the basis on which the company's residential status is determinable.

According to Section 6(3) a non-Indian company would be resident in India only if the whole of the control and management of its affairs throughout the relevant previous year are exercised from India. In other words, even if a negligible part of the control and management is exercised from outside India the company would be a non-resident for income-tax purposes. Thus, a foreign company with its registered office outside India could be treated as resident in India if the control of its affairs is exercised wholly from India. Like other tax payers, a company may also be resident in more places than one although it can have only one registered office. The residential status of a company and the place of its control and management should not be decided by the location of the registered office of the company.

Important Points

- As a rule, the direction, management and control, the head, seat and directing power of a company's affairs is situated at the place where the directors meetings are held.
- Consequently a company would be resident in the country if the meetings of directors who manage and control the business are held there. It is not what the directors have power to do, but what they actually do, that is of importance in determining the question of the place where the control is exercised. (Egyptian Hotels Ltd. v. Mitchell 6 T.C. 542). In this case Lord Sumner said:

Where the directors forbore to exercise their powers, the bare possession of those powers was not equivalent to taking part in or controlling the trading. Control means *de facto* control and not merely *de jure* control.

- The control and management of a company's affairs is not situated at the place where the shareholders meetings are held, even if one shareholder, by reason of his holding an absolute majority of shares, has a decisive voice in matters relating to the company's affairs.
- It should be noted that the test for ascertaining the residential status of a non-Indian company on the basis of the control and management of its affairs is exactly opposite to that applied in the case of firms or HUF. A company will be resident in India only if the whole of the control of its affairs is exercised from India while a firm will be resident even if a very small portion is exercised from India.

It must be noted that only an individual or a HUF can be resident, not ordinarily resident or non-resident in India. All other assesses can be either resident or non-resident in India but cannot be not ordinarily resident in the matter of their residential status for all purposes of income tax.

CHARGE OF INCOME-TAX (SECTION 4)

Section 4 of the Act is the charging section. A section in a Act, which imposes a charge is referred to as a charging section and a section merely providing rules for working out the charge so imposed is referred to as a machinery section. It lays down the basis on which tax is imposed.

Accordingly, this section provides that:

- (a) income-tax shall be charged at the rate or rates prescribed in the Finance Act for the relevant previous year; (discussed in 1st lesson)
- (b) the charge of tax is on various persons specified in Section 2(31) (definition of persons, discussed in 1st lesson);
- (c) the income sought to be taxed is that of the previous year and not of the of assessment year; and
- (d) the levy of tax on the assessee is on his total or taxable income computed in accordance with and subject to the appropriate provisions of the Income-tax Act, including provisions for the levy of additional income-tax.

The assessment should, in every case, be made in accordance with the provisions of the law in force in the relevant assessment year and not the law applicable to the previous year.

Exceptions

For the purpose of making an assessment, the general rule is that the income of the previous year alone should be taxed in the immediately following assessment year.

However, there are five exception to this rule:

- (a) *Assessment of non-residents in respect of their income from shipping business (Section 172).*
- (b) *Assessment of persons leaving India (Section 174).*
- (c) *Assessment of association of persons or body of individuals or artificial juridical person formed for a particular event or purpose (section 174A).*
- (d) *Assessment of persons trying to alienate their assets with the object of avoiding liability to tax (Section 175).*
- (e) *Assessment of the income from discontinued business (Section 176).*

In all the above five cases the tax authorities are entitled (and even bound) to tax the income in the previous year instead of postponing the assessment to the immediately following assessment year. The provisions relating to these special assessments are discussed hereunder:

(a) Shipping business of non-resident (Section 172)

In the case of a non-resident shipping company, which has no representative in India, any income derived from carrying passengers, livestock, mail or goods shipped at a port in India, will be taxed in the year of its earnings. 7.5% of the amount paid or payable on account of such carriage will be deemed to be the income. Such ship will be allowed to leave the port if the tax on such income has been paid or alternative arrangements to pay tax are made.

(b) Assessment of persons leaving India (Section 174)

When it appears to the Assessing Officer that any individual may leave India during the current assessment year or shortly after its expiry and that he has no intention of returning to India, the total income of such individual for the period from the expiry of the previous year upto the probable date of departure from India shall be chargeable to tax in that assessment year.

The income shall be chargeable to tax at the rate or rates in force in that assessment year but separate assessments shall be made in respect of each such completed previous year or part of any previous year. If it is not possible to determine the income of the assessee in the manner provided in the Act, the Assessing Officer shall estimate the income for the period in question.

For making assessment under this section the Assessing Officer may serve a notice upon the assessee to

furnish within such time, but not less than 7 days, as may be specified by the Assessing Officer in the notice, a return of his total income for the previous year and his estimated income for any part of the previous year comprised in that period. On receipt of the notice the assessee shall file the return and shall be taxed accordingly.

(c) Assessment of association of persons or body of individuals or artificial juridical person formed for a particular event or purpose (Section 174A)

Where it appears to the Assessing Officer that any association of persons or a body of individuals or an artificial juridical person, formed or established or incorporated for a particular event or purpose is likely to be dissolved in the assessment year in which such association of persons or a body of individuals or an artificial juridical person was formed or established or incorporated or immediately after such assessment year, the total income of such association or body or juridical person for the period from the expiry of the previous year for that assessment year up to the date of its dissolution shall be chargeable to tax in that assessment year, and the provisions of Section 174 shall, so far as may be, apply to any proceedings in the case of any such person as they apply in the case of persons leaving India.

(d) Transfer of property to avoid tax (Section 175)

If it appears to the Assessing Officer that during any current assessment year any person is likely to charge, sell, transfer, dispose of or otherwise part with any of his assets with a view to avoiding payment of any liability under Income-tax Act, the total income of such person for the period from the expiry of the previous year for that assessment year to the date when the Assessing Officer commences proceedings under this section shall be chargeable to tax in that assessment year.

The provisions of Section 174 [already discussed above] shall apply to the proceedings under this Section also.

(e) Discontinued business (Section 176)

Discontinuance denotes the cessation of the business or profession. There can be no discontinuance when a business or profession is sold to another. However, when a business is broken into several units and is divided and carried on by its former owners severally, there would be discontinuance.

Where any business is discontinued in any assessment year, the income of the period from the expiry of the previous year for that assessment year upto the date of such discontinuance may, at the discretion of Assessing Officer be charged to tax in that assessment year. Any person discontinuing a business or profession shall give to the Assessing Officer notice of such discontinuance within 15 days thereof. The total income of each completed year or part of any previous year included in the period shall be chargeable to tax at the rates in force in that assessment year and separate assessment shall be made in respect of each completed previous year or part of any previous year.

Example, if a business is discontinued on 14-08-2013 then the income for period 1-04-2013 to 14-08-2013 may be assessed in the previous year 2013-14 itself and the tax will be charged at the rates applicable for advance tax payable during financial year 2013-14.

In the above four exceptions it is mandatory for the assessing officer to charge the tax on the income in the same previous year. But in exception fifth he has the discretionary power to charge tax in the same previous year or he may wait till the assessment year.

MEANING AND SCOPE OF TOTAL INCOME (SECTION 5)

Section 4 of the Act imposes a charge of tax on the total or taxable income of the assessee. The meaning and scope of the expression of total income is contained in Section 5. The total income of an assessee cannot be determined unless we know the residential status in India during the previous year. The scope of total income and consequently the liability to income-tax also depends upon the following facts:

- (a) whether the income accrues or is received in India or outside,

- (b) the exact place and point of time at which the accrual or receipt of income takes place, and
- (c) the residential status of the assessee.

Scope of Total income has been defined on the basis of Residential status

(A) Resident and Ordinarily Resident Assessee

According to Sub-section (1) of Section 5 of the Act the total income of a resident and ordinarily resident assessee would consist of:

- (i) income received or deemed to be received in India during the accounting year by or on behalf of such person;
- (ii) income which accrues or arises or is deemed to accrue or arise to him in India during the accounting year;
- (iii) income which accrues or arises to him outside India during the accounting year.

It is important to note that under clause (iii) only income accruing or arising outside India is included. Income deemed to accrue or arise outside India is not includible

(B) Resident but Not Ordinarily Resident In India

Proviso to section (1) of section 5 the total income in case of resident but not ordinarily resident in India

- (i) income received or deemed to be received in India during the accounting year by or on behalf of such person;
- (ii) income which accrues or arises or is deemed to accrue or arise to him in India during the accounting year;
- (iii) income which accrues or arises to him outside India during the previous year if it is derived from a business controlled in or a profession set up in India.

(C) Non-Resident

Sub-section (2) of Section 5 provides that the total income of a non-resident would comprise of:

- (i) income received or deemed to be received in India in the accounting year by or on behalf of such person;
- (ii) income which accrues or arises or is deemed to accrue or arise to him in India during the previous year.

Income received

Income received in India is taxable regardless of the assessee residential status therefore it has great significance.

- (i) The receipt contemplated for this purpose refers to the first receipt of the amount in question as the income of the assessee.

For instance, if A receives his salary at Delhi and sends the same to his father, the salary income of A is a receipt for tax purposes only in the hands of A; his father cannot also be said to have received income when he receives a part of the income of A. In the hands of A's father it is only a receipt of a sum of money but not a receipt of income.

- (ii) Method of Accounting: Although receipt of income is not the sole test of its taxability, the receipt of income would be the primary basis for determining the taxability of the amount in cases where the assessee follows the cash system of accounting; however, where the assessee follows the mercantile system of accounting the income would become taxable as the income of the accounting year in which it falls due to the assessee regardless of the date or place of its actual receipt.

- (iii) While considering the receipt of income for tax purposes both the place and the date of its receipt must be taken into account. The income in question should be not only received during the accounting year relevant to the assessment year but must also be received in India in order to constitute the basis of taxation. Thus, if an item of income is first received outside India and after a few years is brought into India the subsequent receipt of the same amount in India should not be taken as the basis of taxing the same since the same income cannot be received twice and it will be known as Remittances.
- (iv) For the purpose of taxation both actual and constructive receipt must be taken into account. Receipt by some other person on behalf of the assessee should be treated as receipt by the assessee for being taxed in his hands.
- (v) The question of taxability of a particular income received by the assessee depends upon the nature of income. For instance, income from salaries and interest on securities would attract liability to tax immediately when it falls due to the assessee regardless of its actual receipt by or on behalf of the assessee.

Place and date of receipt of income:

The place and date of receipt of income are two important factors for levying tax. When the amount is received in cash and directly from the debtor, there is no difficulty in deciding the place and date of receipt. But when the payment is made by cheque or by post, the place and date of receipt is determined as follows:

(i) Date of receipt when receipt is by cheque

If the payment is made by the drawee on presentment of the cheque, the date of receipt of the cheque and not the date of its encashment shall be the date of receipt.

(ii) Place of receipt when payment is made by cheque and by post

In this case, if the Post Office is the agent of the creditor, the place of posting by the debtor shall be regarded as the place of receipt by the creditor. If, on the other hand, there is no specific understanding that the payment is to be made by post, the place of receipt by the creditor would be the place of receipt.

(iii) Place of receipt when receipt is through a Postal Money Order, or by Insured Post

In this case, the place of receipt is to be determined on the basis of who (creditor or debtor) bears the postal expenses. If the postal expenses are borne by the creditor, the place of debtor would be place of receipt. If, on the other hand, the debtor bears the postal expenses, the place of creditor would be the place of receipt.

(iv) Date and place of receipt in case of articles sent by V.P.P.

In this case the place of the delivery by the Post Office would be the place of receipt and the date of receipt would be the date of payment by the buyer.

(v) Payment by transfer of immovable property

Whenever any immovable property is accepted in satisfaction of a claim, the date of receipt would not be the date when possession is given but the date of receipt would be when a conveyance is executed.

(vi) Issuing receipt in advance

When a receipt is issued in advance but the payment is not received during the accounting year, it cannot be treated as receipt during the accounting year when the receipt is issued.

Income deemed to be received

In addition to the income actually received by the assessee or on his behalf, certain other incomes not actually received by the assessee and/or not received during the relevant previous year, are also included in his total income for income tax purposes. Such incomes are known as income deemed to be received. Some of the examples of such income are:

- (i) All sums deducted by way of taxes at source (Section 198).
- (ii) Incomes of other persons which are included in the income of the assessee under Sections 60 to 64.
- (iii) The amount of unexplained or unrecorded investments (Section 69).
- (iv) The amount of unexplained or unrecorded moneys, etc. (Section 69A).
- (v) The annual accretion in the previous year to the balance standing at the credit of an employee participating in a Recognised Provident fund to the extent provided in Rule 6 of Part A of the Fourth Schedule [Section 7(i)]. The contributions made by the employer to Recognised Provident Fund in excess of 12% of the employees salary and the interest credited to the Provident Fund account of the employee in excess of the prescribed rate i.e., 8.5% shall be included in the salary income of the employee. This amount is known as annual accretion.
- (vi) The transferred balance in a Recognised Provident Fund to the extent provided in Rule 11(4) of Part A - Fourth Schedule [Section 7(ii)].

When provident fund is recognised for the first time in a particular year, the existing balance to the credit of an employee on the date of recognition, which is carried into the recognised provident fund, is called the transferred balance. The amount of the transferred balance, less the employees own contributions included therein, is deemed to be the income of the year in which recognition takes place. The amount contributed by the employer to the provident fund and the interest on his contribution is included in the income under the head Salaries and the interest on the contributions made by the employee is included in the income under the head "Income from other sources".

- (vii) Any dividend declared by a Company or distributed or paid by it within the meaning of Section 2(22) [Section 8(a)].
- (viii) Any interim dividend unconditionally made available by the Company to the member who is entitled to it [Section 8(b)].
- (ix) The Supreme Court verdict in Standard Triumph Motor Co. Ltd. v. CIT (1993) 201 ITR 391, seems to have made the lot of non-residents in particular more vulnerable. The Court in that case held that a credit entry in the books of the buyer of goods or services in favour of the supplier of goods or services tantamount to receipt of money by the latter. By equating credit entry with receipt itself the judgment exposes non-residents to Indian tax liability where they were not all along liable on the basis of mere credit entry. Because a resident is in any case liable to tax on his world income and therefore this judgment affects a non-resident more than it affects a resident.

Income accrued

The accrual of income is different and distinct from the receipt of income discussed above. Sometimes in the context of accrual or arisal the word earned is used. A person may be said to have earned his income in the sense that he has contributed to the production by rendering of goods or services. But in order that the income may be said to have accrued to him, an additional element is necessary, that is, he must have created a debt in his favour. Income is said to accrue when it comes into existence for the first time or at the point of time when the right to receive the income arises although the right may be exercised or exercisable at a future date. Income is said to be received when it reaches the assessee. When the right to receive the income becomes vested in the assessee, it is said to accrue or arise.

Income is said to accrue only to that person who is lawfully entitled to that income. Income accrues at the place where the source of the income is situated, which may or may not be the same as the place from which the business activities are carried on. Normally, income accrues at the place where the contract yielding the income is entered into and for this purpose the contract should be taken to have been entered into at the place where the offer is accepted.

As already stated, the total income in the case of any non-resident assessee consists of:

- (a) income received or deemed to be received in India, regardless of the place of its accrual, and
- (b) income which accrues or is deemed to accrue in India regardless of the place of its receipt. Thus, the accrual of income as the basis of taxation is more important in the case of non-residents than all other classes of assessees. Accordingly, a non-resident partner of a resident partnership firm carrying on its business outside India is taxable in India on the entire amount of his share of the firms income from its foreign business; such a partner cannot claim tax exemption in respect of even a part of his share of the firms income corresponding to the firms foreign income. This is because of the fact that, so far as the partner is concerned, the source of his income (i.e., his share in firms profits) is situated in India (as the firm is resident in India) and the income consequently arises in India.

Income deemed to accrue or arise in India

According to section 9 of the Act, certain incomes are deemed to accrue or arise in India which are discussed below:

(a) Income by virtue of business connection

- Income arising through or from business connection to any assessee is deemed to accrue or arise in India where a business connection actually exists whether with or without a regular agency, branch or other type of commercial association.
- For purposes of deeming income to accrue or arise in India, the expression 'business connection' must be taken to have wider scope than what is commonly understood by it. It is entirely different from the carrying on of a business although business connection may have some direct or indirect relationship with the business carried on.
- The Supreme Court has held that business does not necessarily mean trade or manufacture only, it is being used as including within its scope professions, vocations and callings [Barendra Prasad Ray and Others v. I.T.O. (1981) ITR, p. 295].
- If income accrues to any person outside India by virtue of his business connection in India, whether directly or indirectly, that income must be deemed to accrue or arise in India for purposes of income-tax assessment.
- In cases where all the operations or activities of a business are not carried on in India but a part of them arise by virtue of the business connection in India, the income which is deemed to accrue or arise in India, should be taken to be only that part which could reasonably be attributed to the operations carried on in India. Rule 10 of the Income-tax Rules contains the basis on which the income attributable to the operations carried out in India could be deemed to accrue or arise in India.
- However, where a substantial part of a non-resident's output is sold in the Indian market through brokers to various customers in India, or mere rendering of services outside India to a person carrying on business in India does not amount to a business connection in India.
- Similarly, where an Indian exporter selling goods through non-resident selling agents, receives sale price in India, credits commission on sales to non-resident agents in his books of account and remits the amount to them later, such commission to non-residents is neither received or deemed to be received in India nor deemed to accrue or arise in India [C.I.T. v. Toshoku Ltd. (1980) 125 ITR p. 525 (S.C.)].

THE MEANING OF THE EXPRESSION 'BUSINESS CONNECTION'

The expression business connection includes:

- (i) the maintenance of a branch office, factory, agency, receivership, management or other establishment for the purchase or sale of goods or for transacting any other business;

- (ii) the erection of a factory where the raw products purchased locally are processed or converted into some form suitable for export outside India;
- (iii) appointing an agent or agents in India for the systematic and regular purchase of raw materials or other commodities or for the sale of the non-residents goods, or for any other purpose;
- (iv) the formation of a close financial association between a resident and a non-resident company which may or may not be related to one another as a holding and subsidiary company;
- (v) the formation of a subsidiary company to sell or otherwise deal with the products of the non-resident parent company;
- (vi) the grant of a continuing licence to a non-resident for the purpose of exploitation for profit of an asset belonging to the non-resident even though the transaction in question may be treated as an out and out sale by the parties concerned.

No Business connection in India in following cases of Non-Resident.

(1) Tax Exemption for encouraging Export :

- For the purpose of encouraging exports, a specific tax concession has been given by providing that no income shall be deemed to accrue or arise in India to a non-resident through or from his operations which are confined to the purchase of goods in India for the purpose of export.
- This exemption is available to a non- resident even though he keeps an office agency for the purpose of buying and export. This exemption is, however, not available to residents or not ordinarily residents.
- In order to qualify for tax exemption, it is essential that the operations of the non- residents, although arising from business connection, should be confined to the purchase of goods for the purpose of export outside India.
- Consequently, the exemption would not be available if the goods purchased in India are sold in India or are not exported outside India.
- Further, if the non-resident works up the raw-materials into finished or semi-finished products, the exemption would be withdrawn and he would become chargeable on such portion of the profits as is attributable to his manufacturing it in India.

(2) Operations confined to collection of news and views for transmission outside India by or on behalf of Non-Resident who is engaged in the business of running news agency or of publishing newspapers, magazines or journals;

(3) Operations confined to shooting of cinematograph films in India if such Non-Resident is:

- (a) an Individual – he should not be a citizen of India; or
- (b) a firm – the firm should not have any partner who is a citizen of India or who is resident in India; or
- (c) a company – the company does not have any shareholder who is a citizen of India or who is resident in India

(b) Income arising from any asset or property in India:

- Income arising in a foreign country from any property situated in India would be deemed to accrue or arise in India.
- In this context, the term property does not refer to house property alone but it refers to all tangible properties whether movable or immovable. For instance, the rent or hire charges for the use of buildings or machinery of the assessee which, under an agreement are payable only outside India, would be deemed to accrue or arise in India.

- Income arising through or from any asset or source of income in India would also be deemed to accrue or arise in India.
- In this context, the term source means not a legal concept but something which a practical man would regard as a real source of income.
- The term property does not refer to the property dealt with by Sections 22 and 23, but it includes any tangible movable or immovable property. The term asset would, however, include all intangible rights and, consequently, interests, dividends, patents and copyrights, royalties, rents etc. will be assets.

(c) Capital asset:

- Capital gains arising to an assessee from the transfer of a capital asset situated in India would be deemed to accrue or arise in India irrespective of the fact whether the capital asset in question represents a movable or immovable property or a tangible or intangible asset.
- It is also immaterial whether the consideration for the transfer of the capital asset is actually paid or payable in India or outside.
- The place of registration of the document of transfer of property is equally immaterial.
- However, if the capital asset, prior to the transfer, is situated outside India, the provisions of Section 9(1) would not apply to deem the capital gains arising on the transfer as accruing or arising in India for purposes of its taxation in India.

(d) Income from salaries

- Income which is chargeable under the head Salaries is deemed to accrue or arise in India in all cases when earned in India. For this purpose income is said to be earned in India if the services are rendered in India.
- The actual place of accrual of the salaries, the residential status of the employer, the citizenship or nationality of the employee and whether the employee is a Government servant or an employee of private enterprise are immaterial.
- However, under Sub-section (2) of Section 9, any pension payable outside India to a person residing permanently outside India should not be deemed to accrue or arise in India if the pension is payable to civil servants and retired judges provided they were appointed before the 15th August, 1947 and continued to serve after the constitution came into operation.
- Barring this exception, non-residents and not ordinarily residents entitled to receive salary or pension earned by them in India would be deemed to receive income which has accrued in India even though the income may be actually accruing and received outside India.
- Income from salaries payable by the Government to a citizen of India outside India for his services rendered outside India, is deemed to accrue or arise in India even though the income is actually accruing outside India and is also received outside India. Thus, under this provision, salary income of all Government servants, working outside India is deemed to accrue in India. In the absence of this provision they would not be chargeable to tax in respect of such income as they would, after some time, become non-residents.
- This provision to deem income as accruing in India applies only in respect of their income from salary but not in respect of the allowances and perquisites to which they are entitled to while serving in a foreign country.
- Section 10(7) of the Income-tax Act, 1961 contains a specific provision to exempt Government servants from tax on their services in a foreign country partly to meet the higher cost of living in that country.

- Salaries paid by the Indian Government in a foreign country to citizens of the foreign country should not, however, be deemed to accrue in India since this provision applies only to Indian citizens employed by the Government who are rendering service outside India.

(e) Taxability of Interest: Interest payable in following cases will be deemed to accrue or arise in India and will be taxable in the hands of recipient irrespective of his residential status (i.e. ROR, RNOR or NR).

Interest payable by:

- (i) Government; or
- (ii) A Resident in India, except where interest is payable in respect of moneys borrowed and used for the purpose of business or profession carried outside India or earning any income from any source outside India (i.e. Interest payable by a Resident for loan used in India for any purpose, whether for business or profession or otherwise);
- (iii) A Non-Resident in India provided interest is payable in respect of moneys borrowed and used for a business or profession carried on in India (i.e. Interest payable by a Non-Resident for loan used for only business or profession in India)

(f) Taxability of Royalty: Royalty payable in following cases will be deemed to accrue or arise in India and will be taxable in the hands of recipient irrespective of his residential status (i.e. ROR, RNOR or NR).

Royalty payable by:

- (i) Government; or
- (ii) A Resident in India except where it is payable in respect of any right/information/property used for the purpose of a business or profession carried on outside India or earning any income from any source outside India (i.e. Royalty payable by a Resident for right/information/property used for any purpose in India whether business or profession or for earning other incomes);
- (iii) A Non-Resident in India provided royalty is payable in respect of any right/information/property used for the purpose of the business or profession carried on in India or earning any income from any source in India (i.e. Royalty payable by a Non-Resident for right/information/property used for any purpose in India whether business or profession or for earning other incomes)

(g) Taxability of Fees for Technical Services: Fees for technical services payable in following cases will be deemed to accrue or arise in India and will be taxable in the hands of recipient irrespective of his residential status (i.e. ROR, RNOR or NR).

Fees for technical services payable by:

- (i) Government; or
- (ii) A Resident in India except where services are utilized for the purpose of a business or profession carried on outside India or earning any income from any source outside India (i.e. Fees for technical services payable by a Resident for services utilised for any purpose in India whether business or profession or for earning other incomes);
- (iii) A Non-Resident in India provided fee is payable in respect of services for the purpose of a business or profession carried on in India or earning any income from any source in India (i.e. Fees for technical services payable by a Resident for services utilised for any purpose in India whether business or profession or for earning other incomes);

(h) Taxability of Dividend :

- Dividend paid by any Indian company outside India is deemed to accrue or arise in India and the income is consequently chargeable to income-tax irrespective of the fact whether the dividend is interim dividend or a final dividend and whether it is an actual dividend or a notional dividend.
- The place of declaration of the dividend is immaterial and the date of payment is equally immaterial for deeming the income to accrue in India.
- Normally, dividend income arises at the place where the source of income is situated, i.e., where the shares yielding the income are kept. Shares are said to be situated at the place where the share register of the company is kept. While the share register of a company should ordinarily be kept at the place where its registered office is located, even if the share register is kept outside India and the dividends are declared outside India, the dividend would still be deemed to accrue in India because the company is an Indian company. It is another matter that dividend paid/payable by Indian companies has been exempted vide Section 10(34) with the introduction of the system of distribution tax which has shifted the incidence of tax on dividend to the company from the shareholder.
- Dividends declared by foreign companies outside India would not, however, be deemed to accrue or arise in India even in cases where the foreign company is resident in India because of the control and management of its affairs being situated wholly in India.
- In order to deem the dividend income as arising in India, the residential status of the shareholder as also the status of the assessee, whether he is an individual, company or local authority, are irrelevant.

Test Your Knowledge

- 1. Which of the following meaning does the expression 'Business Connection' take into account?**
- (a) Building a housing complex
 - (b) Maintenance of branch office
 - (c) Appointing an agent
 - (d) Formation of close financial association

Apportionment of income between spouses governed by Portuguese civil code (Section 5A)

Where the husband and wife are governed by the system of community of property (known under the Portuguese Civil Code of 1860 as COMMUNIAO DOS BENS) in force in the state of Goa and the Union territories of Dadra and Nagar Haveli and Daman and Diu, the income under each head of income (other than under the head salaries) shall be apportioned equally between the husband and the wife and such income shall not be assessed as that of the community of property whether treated as an association of persons or as a body of individuals). Under this provision, even the income from profession will be apportioned equally between the husband and wife. However, in the case of salary income, it will be assessed in the hands of the spouse who has actually earned it. After the income has been apportioned in the aforesaid manner, it will be included separately in the total income of the husband and the wife respectively, and the remaining provisions of the income-tax shall apply accordingly.

Tax incidence vis-a-vis residential status

Tax incidence is vis-a-vis residential status of all assesses is indicated in the following table.

Where tax incidence arises in case of	Resident or Resident & Ordinarily Resident	Resident but not Ordinarily Resident	Non-Resident
Income received in India (Whether accrued in or outside India)	YES	YES	YES
Income deemed to be received in India (Whether accrued in or outside India)	YES	YES	YES
Income accruing or arising in India (Whether received in India or outside India)	YES	YES	YES
Income deemed to accrue or arise in India (Whether received in India or outside India)	YES	YES	YES
Income received and accrued outside India from a business controlled or a profession set up in India	YES	YES	NO
Income received and accrued outside India from a business controlled from outside India or a profession set up outside India	YES	NO	NO
Income earned and received outside India but later on remitted to India (whether tax incidence arises at the time of remittance?)	NO	NO	NO
Past untaxed profits (not taxable as relates to past years)	NO	NO	NO
Agricultural Income in India [Exempt under Section 10(1)]	NO	NO	NO
Long term capital gain [on STT paid shares or on shares sold through stock exchange] Exempt u/s 10(38)	NO	NO	NO
Dividend from a Domestic Company [Exempt u/s 10(34)] or Income from Mutual funds specified u/s 10(23D) [Exempt u/s 10(35)]	NO	NO	NO
Gifts from relatives or on marriage or under will etc. (or gifts from others upto ₹ 50,000 in a year)	NO	NO	NO

The above table depicts that the first four incomes are chargeable to tax in India in respect of all assesses, irrespective of their residential status. In the case of a resident or resident and ordinarily resident assessee, tax incidence is the highest as income accruing in any part of the world attracts tax incidence in India. The tax incidence, on the other hand, is the lowest in the case of non-resident as only such income as accrued or is received or deemed to be received in India is liable to tax.

In respect of incomes which are deemed to accrue or arise in India, it is immaterial as to who the assessee is or what the nature or status of the assesses position in India is. In all the above seven cases, the necessity to apply this provision arises where the income is actually accruing or arising outside India. Where the income actually arises in India or is received in India, the question of applying the provisions of Section 9 to deem them to accrue or arise in India does not arise.

When income is deemed to accrue or arise in India, it is essentially implied that the income in question does not accrue in India. Since income which is deemed to accrue or arise in India is taxable in the hands of all assesses regardless of their residential status, nationality, citizenship, place of birth, the domicile or business, the implications of this section are of great importance in the case of all assesses and, more particularly, in the case of non-residents and persons who are not ordinarily residents in India who, but for this section, would not be chargeable to tax on their income accruing or arising outside India.

Test Your Knowledge



2. Tax exemption is available to a non-resident even though he/she keeps an office agency for the purpose of buying and export.

- True
- False

Illustration: Mr. A earns the following income during the previous year ended 31st March, 2014. Determine the income liable to tax for the assessment year 2014-15 if Mr. A is (a) resident and ordinarily resident in India, (b) resident and not ordinarily resident in India, and (c) non-resident in India during the previous year ended 31st March, 2014.

- Profits on sale of a building in India but received in Holland- ₹ 20,000
- Pension from former employer in India received in Holland- ₹ 14,000
- Interest on U.K. Development Bonds (1/4 being received in India) - ₹ 20,000
- Income from property in Australia and received in U.S.A. - ₹ 15,000
- Income earned from a business in Abyssinia which is controlled from Jullundur (₹ 30,000 received in India) - ₹ 70,000
- Dividend on shares of an Indian company but received in Holland [not qualifying for exemption under Section 10(34)] - ₹ 10,000
- Profits not taxed previously brought into India- ₹ 40,000
- Profits from a business in Nagpur which is controlled from Holland- ₹ 27,000

Solution: Computation of income liable to tax:

Particular	Resident & Ordinarily (₹)	Resident but not Ordinarily Resident (₹)	Non-Resident (₹)
Profits on sale of a building in India but received in Holland	20,000	20,000	20,000
Pension from former employer in India received in Holland	14,000	14,000	14,000
Interest on U.K. Development Bonds (1/4th taxable on receipt basis)	5,000	5,000	5,000
Interest on U.K. Development Bonds (3/4th taxable on receipt basis)	15,000	Nil	Nil

Income from property in Australia and received in U.S.A.	15,000	Nil	Nil
Income earned from a business in Abyssinia which is controlled from Jullundur	70,000	70,000	30,000
Dividend on shares of an Indian company but received in Holland	10,000	10,000	10,000
Profits not taxed previously brought into India (Not an income so not taxable)	Nil	Nil	Nil
Profits from a business in Nagpur which is controlled from Holland	27,000	27,000	27,000
Total	1,76,000	1,46,000	1,06,000

Illustration: X had the following income during the previous year ended 31st March, 2014:

- Salary Received in India for three Months - ₹9,000
- Income from house property in India- ₹13,470
- Interest on Saving Bank Deposit in State Bank of India- ₹ 1,000
- Amount brought into India out of the past untaxed profits earned in Germany- ₹20,000
- Income from agriculture in Indonesia being invested there-₹12,350
- Income from business in Bangladesh, being controlled from India- ₹10,150
- Dividends received in Belgium from French companies,out of which ₹ 2,500 were remitted to India- ₹23,000

You are required to compute his total income for the assessment year 2014-15 if he is: (1) a resident; (ii) a not ordinarily resident, and (iii) a Non-resident.

Solution: Computation of total income of X is given below:

Particular	Resident & Ordinarily (₹)	Resident but not Ordinarily Resident (₹)	Non-Resident (₹)
Salary Received in India for three Months (Indian received in India)	9,000	9,000	9,000
Income from house property in India (Income accrue or arise in India)	13,470	13,470	13,470
Interest on Saving Bank Deposit in State Bank of India (Income accrue or arise in India)	1,000	1,000	1,000
Amount brought into India out of the past untaxed profits earned in Germany (not an income, hence not taxable)	Nil	Nil	Nil
Income from agriculture in Indonesia being invested there (Income accrue or arise in outside India)	12,350	Nil	Nil
Income from business in Bangladesh, being controlled from India (it is supposed that the money is not received in India) (Income accrued outside India from a business controlled from India)	10,150	10,150	Nil

Dividends received in Belgium from French companies (Income accrue outside India India remittance is irrelevant)	23,000	Nil	Nil
Total	68,970	33,620	23,470

Illustration: Mr. Y earns the following income during the previous year ended on 31st March, 2014. Determine the income liable to tax for the assessment year 2014-15 if Mr. Y is (a) resident and ordinary resident (b) resident and not ordinary resident, and (c) non-resident in India during the previous year ended on 31st March, 2014.

- (i) Honorarium received from Government of India (Travelling and other incidental expenses of ₹ 7,000 were incurred in this connection)- ₹20,000
- (ii) Profits earned from a business in Tamilnadu controlled from Pakistan - ₹50,000
- (iii) Profits earned from a business in U.K. controlled from Delhi- ₹ 30,000
- (iv) Profits earned from a business in U.S.A. controlled from Pakistan and amount deposited in a bank there- ₹40,000
- (v) Income from a house property in France, received in India-₹ 10,000
- (vi) Past untaxed foreign income brought into India during the year- ₹ 25,000
- (vii) Dividends from a German company credited to his account in Pakistan- ₹35,000
- (viii) Dividends declared but not received from an Indian company- ₹20,000
- (ix) Agricultural income from Burma not remitted to India-₹ 40,000
- (x) Pension for services rendered in India, but received in Pakistan- ₹ 30,000

Solution: Computation of Income liable to tax of Mr. Y is given below:

Particular	Resident & Ordinarily (₹)	Resident but not Ordinarily Resident (₹)	Non- Resident (₹)
Honorarium received from Govt. of India	20,000	20,000	20,000
Profits earned from a business in Tamilnadu controlled from Pakistan (Income accrue or arise in India)	50,000	50,000	50,000
Profits earned from a business in U.K. controlled from Delhi (Income accrue or arise outside India from a business controlled from India)	30,000	30,000	-
Profits earned from a business in USA controlled from Pakistan and amount deposited in a Bank there (Income accrue outside India)	40,000	-	-
Income from a house property in France, received in India (Income received in India)	10,000	10,000	10,000
Past untaxed foreign income brought into India during the year (Not taxable as profit of past years, also remittance is irrelevant)	-	-	-
Dividends from a foreign company credited to his account in Pakistan (Income accrue outside India)	35,000	-	-

Dividends declared but not received from an Indian company [u/s 10(33) enjoys exemption]	-	-	-
Agricultural income from Burma not remitted to India (Income accrue outside India)	40,000	-	-
Pension for Services rendered in India, but received in Pakistan (Income deemed to accrue or arise in India)	30,000	30,000	30,000
Total	2,55,000	1,40,000	1,10,000

LESSON ROUND UP

- Total income of an assessee cannot be computed unless the person's residential status in India during the previous year is known. According to the residential status, the assessee can either be;
 - (i) Resident in India or
 - (ii) Non-resident in India
 - Section 6 of the Income-tax Act prescribes the tests to be applied to determine the residential status of all tax payers for purposes of income-tax. There are three alternative tests to be applied for individuals, two for companies and Hindu Undivided Families and firms, associations of persons, bodies of individuals and artificial juridical persons.
 - Residential status of Individual: The residential status of individual is determined on the basis of the following conditions:
 - (i) Condition 1: If individual is in India in the previous year for a total period of 182 days or more.
 - (ii) Condition 2: If he has been in India for at least 365 days during the 4 years preceding the previous year and has been in India for at least 60 days during the previous year. However this clause will not be applicable if he is a:
 - Citizen of India, who leaves India in any previous year as a member of the crew of an Indian ship, or for the purpose of employment outside India. OR
 - Citizen of India or of Indian origin engaged outside India (whether for rendering service outside or not) and who comes on a visit to India in the any previous year.
 - (iii) Condition 3: An individual who has been a non-resident in India in at least nine out of the ten previous years preceding that year, and has during the seven previous years preceding that year been in India for a period of, or periods amounting in all to 729 days or less.
- Resident and Ordinarily Resident- (Satisfies any one condition from 1 & 2 and condition 3)
- Not ordinarily resident – Satisfies any one condition from 1 & 2
- Non-resident – Does not satisfy any condition from 1 and 2
- Residential status of HUF: The test to be applied to determine the residential status of a HUF, Firm or other Association of Persons is based upon the control and management of the affairs of the assessee concerned. A HUF, firm or other association of persons is said to be resident in India within the meaning of Section 6(2) in any previous year, if during that year the control and management of its affairs is situated wholly or partly in India during the relevant previous year. If the control and management of its affairs is situated wholly outside India during the relevant previous year, it is considered non resident.
 - A HUF can be “*not ordinarily resident*”

- If manager/karta has been a not ordinarily resident in India in the previous year in accordance with the tests applicable to individuals.
- Firms, association of persons, local authorities and other artificial juridical persons can be either resident (ordinarily resident) or non-resident in India but they cannot be not ordinarily resident in India.
- Residential status of Companies: All Indian companies within the meaning of Section 2(26) of the Act are always resident in India regardless of the place of control and management of its affairs.

In the case of a foreign company the place of control and management of the affairs is the basis on which the company's residential status is determinable.

- Basis of charge: Section 4 of the Act is the charging section. A section in a Act, which imposes a charge is referred to as a charging section and a section merely providing rules for working out the charge so imposed is referred to as a machinery section.

Section 4 of the Act imposes a charge of tax on the total or taxable income of the assessee. The meaning and scope of the expression of total income is contained in Section 5. The total income of an assessee cannot be determined unless we know the residential status in India during the previous year. the scope of total income and consequently the liability to income-tax also depends upon the following facts:

- whether the income accrues or is received in India or outside,
- the exact place and point of time at which the accrual or receipt of income takes place, and
- the residential status of the assessee.

SELF TEST QUESTIONS

These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation.

MULTIPLE CHOICE QUESTIONS

- (1) Income accruing in India in previous year is taxable for –
 - Resident
 - Not ordinarily resident
 - Non-resident
 - All of the above.
- (2) Income accruing from agriculture in a foreign country is taxable in the case of an assessee who is –
 - Resident
 - Not-ordinarily resident
 - Non-resident
 - None of the above.
- (3) Foreign income received in India during the previous year is taxable in the case of –
 - Resident
 - Not-ordinarily resident
 - Non-resident
 - All of the above.

(4) Every year, the residential status of an assessee —

- (a) May change
- (b) Will certainly change
- (c) Will not change
- (d) None of the above.

FILL IN THE BLANKS

- (1) The residential status of an assessee is determined for the relevant _____.
- (2) The incidence of tax on any assessee depends upon his _____ under the Act.
- (3) If control and management of the affairs HUF is situated wholly outside India it would become a _____.

TRUE AND FALSE

- (1) An Indian company is always resident in India no matter where and to what extent its control and management is situated.
- (2) Sandeep Ltd. is a company registered in Japan. The control and management of its affairs is wholly situated in India. Sandeep Ltd. is non-resident company in India.

SHORT NOTES

- (1) Taxability of income by virtue of business connection
- (2) Income deemed to be received in India
- (3) Income deemed to accrue or arise in India

DISTINGUISH BETWEEN

- (1) Resident and Not Ordinary Resident
- (2) Domestic Company and Foreign Company
- (3) Resident and Non-Resident

ELABORATIVE

- (1) What are the different categories into which the assessees are divided regarding residence and how is the residence of assessees determined for income-tax purposes? Explain.
- (2) What tests would you apply to determine the residence of :
 - (a) a Hindu Undivided family,
 - (b) a firm,
 - (c) a limited company,
 - (d) an individual.

ANSWERS/HINTS

Multiple choice questions

1(d); 2(a); 3(d); 4(a)

Fill in the Blank

1 Previous year; 2 Residential status; 3 Non-Resident

True and False

1 True; 2 False

Test Your Knowledge

1. Business connection take into account (b) Maintenance of branch office, (c) Appointing an agent and (d) Formation of close financial association.

2. True

SUGGESTED READINGS

1. Dr. V.K. Singhania : Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.

2. Girish Ahuja and Ravi Gupta : Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.

Lesson 3

Incomes which do not Form Part of Total Income

LESSON OUTLINE

- General Exemption
 - Exemption under section 10
- Specific Exemption
 - Special provisions in respect of newly established Units in Special Economic Zone (Section 10AA)
- Exemptions for Charitable Trusts and Institutions
 - Meaning of certain terms
 - Income not to be included in the Total Income
 - Capital Gains [Section 11(1A)]
 - Accumulations of Income [Section 11(2)]
 - Forms and Modes of Investment [Section 11(5)]
 - Income from Voluntary Contributions (Section 12)
 - Income to be included in Total Income [Section 13(1)]
 - Conditions as to Registration of Trusts, etc. (Section 12A)
- Exemption for Political Parties
 - Tax Exemptions to Political Parties (Section 13A)
 - Voluntary contributions received by an Electoral Trust (Section 13B)
- Lesson Round UP
- Self Test Question

LEARNING OBJECTIVES

Tax is calculated on the income earned in the previous year. For providing relief to the tax payers from payment of tax, income tax law provisions contains concept of exemption and deduction. Exempted income means the income which does not at all charged to any taxes, while calculating the Gross Total Income. Under Income Tax Law, section 10 provides for incomes which are exempted from levy of income tax for example Scholarship, whereas deduction means the amount which needs to be included in the income first then they are allowed for deduction in full or in part on fulfillment of certain conditions. For example, deduction for payment of donations under section 80G. This lesson deals with incomes which do not form part of total income, covering sections 10, 10AA, 11, 12, 12A, 13 and 13A. Section 10 provides for various categories of income that are exempt from tax. Section 10AA, deals with exemption in respect of income of industrial units in special economic zones. Section 11 provides exemption in respect of income derived from property held under trust wholly for charitable or religious purposes and section 13A exempts income derived by a political party.

After going through this lesson, you will learn about the income which does not form part of the total income, the conditions to be satisfied for availing exemption under section 10, 10AA, 11, 12, 12A, 12B, 13A & 13B.

GENERAL EXEMPTION

Under Section 10 of the Income-tax Act, various items of income are totally exempt from income-tax. Therefore, these incomes are not included in the total income of an assessee.

Section 10 provides that in computing the total income of a previous year of any person, any income falls in its ambit shall not be included in the total income, provided the assessee proves that a particular item of income is exempt and falls within a particular clause. The onus is on the assessee i.e. the assessee has to prove that his income falls under Section 10.

The items of 'exemptions' specified in Section 10, are explained as follows:

AGRICULTURAL INCOME [SECTION 10(1)]

Agricultural income as defined in Section 2(1A) is exempt from income-tax in the case of all assesses. This exemption has been granted on account of the constitutional provisions relating to the powers of the Central and the State Governments for levying tax on agricultural income.

Under the Constitution only the State Governments are empowered to levy tax on agricultural income. Hence, the Central Government while imposing income-tax on incomes of various types has specifically excluded agricultural income from the purview of Central income-tax. This exemption would, however, be available only in cases where the income in question constitutes agricultural income within the meaning of Section 2(1A).

Definition of Agricultural Income

As per section 2(1A) of the Act, agricultural income is defined as follows:

Agricultural income means –

- (a) Any rent or revenue derived from land which is situated in India and is used for agricultural purposes;
- (b) Any income derived from such land by –
 - (i) agriculture; or
 - (ii) the performance by a cultivator or receiver of rent-in-kind of any process ordinarily employed by a cultivator or receiver of rent-in-kind to render the produce raised or received by him fit to be taken to market; or
 - (iii) the sale by a cultivator or receiver of rent-in-kind of the produce raised or received by him, in respect of which no process has been performed other than a process of the nature described in paragraph (ii) of this sub-clause ;
- (c) Any income derived from any building owned and occupied by the receiver of the rent or revenue of any such land, or occupied by the cultivator or the receiver of rent-in-kind, of any land with respect to which, or the produce of which, any process mentioned in paragraphs (ii) and (iii) of sub-clause (b) is carried on:

Provided that –

- (i) the building is on or in the immediate vicinity of the land, and is a building which the receiver of the rent or revenue or the cultivator, or the receiver of rent-in-kind, by reason of his connection with the land, requires as a dwelling house, or as a store-house, or other out-building, and
- (ii) the land is either assessed to land revenue in India or is subject to a local rate assessed and collected by officers of the Government as such or where the land is not so assessed to land revenue or subject to a local rate, it is not situated –
 - (A) in any area which is comprised within the jurisdiction of a municipality (whether known as a

municipality, municipal corporation, notified area committee, town area committee, town committee or by any other name) or a cantonment board and which has a population of not less than ten thousand ; or

- (B) in any area within the distance, measured aerially,—
 - (I) not being more than two kilometres, from the local limits of any municipality or cantonment board referred to in item (A) and which has a population of more than ten thousand but not exceeding one lakh; or
 - (II) not being more than six kilometres, from the local limits of any municipality or cantonment board referred to in item (A) and which has a population of more than one lakh but not exceeding ten lakh; or
 - (III) not being more than eight kilometres, from the local limits of any municipality or cantonment board referred to in item (A) and which has a population of more than ten lakh.

Explanation 1. – For the removal of doubts, it is hereby declared that revenue derived from land shall not include and shall be deemed never to have included any income arising from the transfer of any land referred to in item (a) or item (b) of sub-clause (iii) of clause (14) of this section.

Explanation 2. – For the removal of doubts, it is hereby declared that income derived from any building or land referred to in sub-clause (c) arising from the use of such building or land for any purpose (including letting for residential purpose or for the purpose of any business or profession) other than agriculture falling under sub-clause (a) or sub-clause (b) shall not be agricultural income.

Explanation 3. – For the purposes of this clause, any income derived from saplings or seedlings grown in a nursery shall be deemed to be agricultural income.

Explanation 4. – For the purposes of clause (ii) of the proviso to sub-clause (c), “population” means the population according to the last preceding census of which the relevant figures have been published before the first day of the previous year;

Conditions to be satisfied for Agricultural Income

According to the definition of Agricultural Income as per Section 2(1A) of the Act, the income which satisfies following conditions is treated as agricultural income.

(a) Rent or revenue derived from land:

- The word rent denotes the payment of money either in cash or in kind by one person to another (owner of the land) in respect of grant of right to use land.
- The recipient of rent or revenue should be the owner of the land.
- The expression revenue is used in the broader sense of return, yield or income, and not in the sense of land revenue.
- Income is said to be derived from land only if the land is the immediate and effective source of the income and not the secondary and indirect source. Thus interest on arrears of rent payable in respect of agricultural land is not agricultural income because the source of income (interest) is not from land but it is from rent which is a secondary source of income and is taxable under the head Income from other sources. [CIT v. Kamakshya Narain Singh [(1948) 16 ITR 325].

(b) Land must be situated in India:

Land must be situated in India but it is immaterial whether the agricultural land in question has been assessed to land revenue or local taxes assessed and collected by the Officers of the Government in India.

(c) Land must be used for agricultural purpose:

The land must be used for agricultural purposes. There must be some measure of cultivation on the land, some expenditure of skill and labour upon it, to have been used for agricultural purposes within the meaning of the Act. [Mustafa Ali Khan v. CIT (16 ITR 330)]. The operations on the land for agricultural purposes can be:

(i) Basic operation:

These include tilling of the land, sowing of seeds, planting or an operation of a similar kind (digging pits in the soil to plant a sapling).

(ii) Subsequent operations:

These include weeding, digging the soil around the growth, nursing, pruning, cutting, etc.

If the person has performed the basic operations on the land whether he has performed the subsequent operations or not.	The income shall be agricultural income. For example: Seller of standing crops, who has put in labour and skill to make the crop sprout out of the land, is agricultural income.
If the person has not performed the basic operations on the land but he has performed the subsequent operations	The income shall not be agricultural income for him and it will be taxable under the head Business/ Profession. For example: If a person purchases a standing crop, and makes a profit out of it, the income is not agricultural income

Note: Here agriculture connotes all the products of vegetable kingdom (food for human beings and animals, fruits, commercial crops, flowers, medicines, bamboo, timber, fuel material) but it does not include the products of animal kingdom (dairy farming, butter and cheese making, poultry farming, breeding of live stock etc.).

Concept of Agricultural Income

Agricultural Income means and includes

I. Rent received from the land used for agricultural purposes:

When a person (landlord or tenant) lets out a piece of land, which is situated in India, for agricultural purposes, the rent received either in cash or kind from the tenant is considered as agricultural income.

II. Revenue income derived from agriculture

When the landlord or tenant cultivates the farm, raises the product and sells it or appropriates it for his individual needs, the difference between the cost and selling price (including the value of self consumption on the basis of average market rate for the year) is the income derived from agriculture.

III. Income from making the produce fit to be taken to market

The crop as harvested might not find a market. If, in order to make the product a saleable commodity, the cultivator or receiver of rent-in-kind performs some operation (manual or mechanical) and enhances the value of the produce, the enhancement of value of the produce is also agriculture income. Such income to be regarded as agricultural income, the following conditions must be satisfied:

- (i) The operation must be one which is ordinarily employed by the cultivator to make the produce fit for market, i.e., threshing, winnowing, cleaning, drying, etc.
- (ii) There is no market (ready and willing and not a theoretical market) for the produce as received from the farm.
- (iii) The process to make it marketable has been performed either by the cultivator or receiver of rent-in-kind.
- (iv) The produce must not change its original character.

Example:

- (a) There is no ready market for raw coffee in the green state. It has to be dried-up and cured before it can be sold. In the same way, the conversion of the green tobacco leaves into fluecured tobacco is a must before sale. On the other hand, there is a ready market of kapas or unginned cotton. If the

farmer sells the ginned cotton, the additional income (difference between the selling price of ginned cotton and unginned cotton) is not agricultural income and is therefore liable to tax.

- (b) Similarly, where a farmer grew mulberry leaves and fed the same to silk-worm, it was not a process employed by the cultivator of mulberry leaves to make them marketable by way of producing silk cocoons, and the income derived from rearing of silk-worms was not agricultural income because the silk cocoons produced by silk-worms did not bear any character of an agricultural produce or as a marketable form of mulberry leaves. [K. Lakshmansa & Co. v. CIT (1981) 128 ITR, p. 283 (Kar.)].

IV. Income from sale of produce:

When the cultivator or receiver of rent-in-kind sells the produce either after performing certain activities to make it fit for market (discussed in III above) or without doing any such activity, the income is agricultural income. It is immaterial that he has sold the produce to the wholesaler in the market or through his own retail shop directly to the consumers.

V. Income from Building:

In the following cases the income from building or house property is treated as agricultural income:

- (a) (i) If the land-lord receives rent in cash, it is owned and occupied by him; or
 - (ii) If the land-lord receives rent-in-kind, it is occupied by him -whether owned or not; or
 - (iii) if it is occupied by the cultivator - whether owned by him or not;
- (b) If it is on or in the immediate vicinity of the agricultural land;
- (c) If it is required as a dwelling-house or as a store house or as an out-house by the land-lord or cultivator;
- (d) If it is required by reason of the land-lords or cultivators connection with the land, i.e., either the building is required to make the produce fit to be taken to the market or there is a sufficient quantity of produce which requires a store house or there are numerous tenants and it is necessary to stay there to collect the rent or it is necessary for the cultivator to be there to look after the farm.
- (e) (i) The land is assessed to land revenue in India; or
 - (ii) The land is subject to land revenue or local rate assessed and collected by the officers of the Government - either Central or State for the benefit of local bodies. Where the land is not so assessed, the building should not be situated:
 - (a) in an area of municipality (whether known as Municipal Corporation, Notified Area Committee, Town Area Committee, or by any other name or Cantonment Board whose population according to the latest census figures published is 10,000 or more; or
 - (b) in a notified area within such limits of a Municipality, etc., as may be notified by Government.

However, the distance of notified area cannot exceed 8 kilometres from the local limits. The department has issued various circulars from time to time specifying the notified areas.

Income Connected with Land but not Agricultural Income

There are certain incomes which are derived from land but they are not agricultural incomes because the requisite conditions - land must be used for agricultural purposes and it must be the primary source of income - are not satisfied in such cases. Some of the examples of such incomes are as follows:

- (a) Income from spontaneous growth of grass, trees or bamboos;
- (b) Dividend from a company engaged in agriculture;
- (c) Salary of a farm manager;

- (d) Income from mines;
- (e) Income from stone quarries;
- (f) Income from fisheries;
- (g) Income from brick making;
- (h) Income from supply of water for irrigation purposes;
- (i) Profit accruing from the purchase of a standing crop and resale thereof after harvest;
- (j) Income from animal kingdom.

Partly Agricultural Income [Rules 7 and 8 of the Income-tax Rules, 1962]

As per Rule 7 of the Income-tax Rules, 1962- In the case of income which is partially agricultural income as defined in section 2 and partially income chargeable to income-tax under the head "Profits and gains of business", in determining that part which is chargeable to income-tax the market value of any agricultural produce which has been raised by the assessee or received by him as rent-in-kind and which has been utilized as a raw material in such business or the sale receipts of which are included in the accounts of the business shall be deducted, and no further deduction shall be made in respect of any expenditure incurred by the assessee as a cultivator or receiver of rent-in-kind. For this purpose "market value" shall be deemed to be: –

- (a) where agricultural produce is ordinarily sold in the market in its raw state, or after application to it of any process ordinarily employed by a cultivator or receiver of rent-in-kind to render it fit to be taken to market, the value calculated according to the average price at which it has been so sold during the relevant previous year;
- (b) where agricultural produce is not ordinarily sold in the market in its raw state or after application to it of any process aforesaid, the aggregate of –
 - (i) the expenses of cultivation;
 - (ii) the land revenue or rent paid for the area in which it was grown; and
 - (iii) such amount as the Assessing Officer finds, having regard to all the circumstances in each case, to represent a reasonable profit.

For example, if a sugar mill has its own farm and the sugarcane grown on the farm has been utilized in the factory, the average market price of the sugarcane shall be deducted from the sale proceeds of sugar while computing the taxable income from business.

Income from manufacture of rubber (Rule 7A)

w.e.f. AY 2002-03

- (1) Income derived from the sale of centrifuged latex or cenex or latex based crepes (such as pale latex crepe) or brown crepes (such as estate brown crepe, remilled crepe, smoked blanket crepe or flat bark crepe) or technically specified block rubbers manufactured or processed from field latex or coagulum obtained from rubber plants grown by the seller in India shall be computed as if it were income derived from business, and thirty-five percent of such income shall be deemed to be income liable to tax.
- (2) In computing such income, an allowance shall be made in respect of the cost of planting rubber plants in replacement of plants that have died or become permanently useless in an area already planted, if such area has not previously been abandoned, and for the purpose of determining such cost, no deduction shall be made in respect of the amount of any subsidy which, under the provisions of clause (31) of Section 10, is not includable in the total income.

Income from the manufacture of coffee (Rule 7B)

- (1) Income derived from the sale of coffee grown and manufactured by the seller in India, with or without mixing of chicory or other flavouring ingredients, shall be computed as if it were income derived from business, and twenty five percent of such income shall be deemed to be income liable to tax.

Income derived from the sale of coffee grown, cured, roasted and grounded by the seller in India, with or without mixing chicory or other flavouring ingredients shall be computed as if it were income derived from business, and forty per cent of such income shall be deemed to be income liable to tax.

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

Income from growing and manufacturing of tea (Rule 8)

Out of the income derived from the sale of tea grown and manufactured by the seller in India, sixty per cent is treated as agricultural income and forty per cent as business income.

In computing the income, with all other costs, the cost of planting bushes in replacement of bushes that have died or become permanently useless shall be deducted. (However, if the assessee has received any tax-free subsidy for replacement of the bushes, such amount shall not be deducted in computing the income).

<i>Nature of income</i>	<i>Income tax Rule applicable</i>	<i>Amount of agricultural income</i>	<i>Amount of non agricultural income</i>
Income from sale of tea manufactured or grown in India	Rule 8	60% of such income	40% of such income
Income from growing and manufacturing of rubber	Rule 7A	65% of such income	35% of such income
Income derived from sale of coffee grown and manufactured in India	Rule 7B	75% of such income	25% of such income
Income derived from sale of coffee grown, cured, roasted and grounded in India	Rule 7B	60% of such income	40% of such income

Treatment of Agricultural Income and Non-Agricultural Income**Partial Integration:**

- As observed earlier, the Finance (No. 2) Act, 1977 has introduced certain modifications in computation of tax payable where the assessee (being an individual, association of persons or body of individuals) has both agricultural income and non-agricultural income.
- It may be mentioned that for the first time Finance Act, 1973 introduced the scheme of inclusion of agricultural income in the total income for the limited purpose of determining the amount of tax payable on the non-agricultural income.
- The scheme applies only to those assessees who have simultaneously net agricultural income exceeding ₹ 5,000 and taxable non-agricultural income i.e. non agricultural income exceeds the basis exemption limit of ₹ 2,00,000 or ₹ 2,50,000 or ₹ 5,00,000 the case may be.

Determination of Tax Liability

While determining the tax-liability, due consideration is to be given to the following rules to arrive at the tax on non-agricultural income:

1. Compute the net agricultural income as if it were income chargeable to income-tax under the head: "Income from other sources".
2. Aggregate agricultural and non-agricultural income of the assessee and calculate income-tax on the aggregate income as if such aggregate income were the total income.
3. Increase the net agricultural income by the first slab of income on which tax is charged at nil rate and calculate income-tax on net agricultural income, so increased, as if such income were the total income of the assessee.
4. The amount of income-tax determined at (2) will be reduced by the amount of income-tax determined at (3).
5. The amount so arrived at will be the total income-tax payable by the assessee.

From the amount of tax determined as above, the following tax reliefs/tax rebates are deductible:

- Rebate under Section 86 in respect of share of profit from an association of persons.
- Rebate under Section 92 in respect of doubly taxed income.

The sum so arrived at will be the income-tax in respect of the total income.

Illustration 1:

Non-agricultural income ₹ 2,00,000. Net agricultural income ₹ 40,000.

Solution:

No income-tax payable as the non-agricultural income does not exceed ₹ 2,00,000.

Illustration 2:

Non-agricultural income ₹ 2,02,000. Net agricultural income ₹ 40,000.

Solution:

	₹
Step 1 : Non-agricultural income + Net Agricultural income	2,42,000
Income-tax thereon (including education cess & SHEC)	4,326
Step 2 : Net agricultural income as increased by a sum of ₹ 2,00,000 + 40,000	2,40,000
Income-tax thereon (including education cess & SHEC)	4,120
Step 3 : Deduct tax arrived at in step 2 from tax arrived at in step 1 (₹ 4,326 – ₹ 4,120)	206
to arrive at tax payable.	

MONEY RECEIVED BY AN INDIVIDUAL AS A MEMBER OF H.U.F. [SECTION 10(2)]

Any sum received by an individual in his capacity as a member of H.U.F. is wholly exempt from income-tax where such sum has been paid out of the income of the family, or out of the income of an imitable estate belonging to the family, because that has been taxed in hand of H.U.F.

This exemption is, however, subject to the provisions of Section 64(2), where the income from self acquired assets which are converted into property of the H.U.F. are to be clubbed with the income of the person who

makes the conversion subject to certain conditions. For the purpose of this exemption, it is immaterial whether the H.U.F. has been subject to tax in respect of the income. It is also immaterial whether the member who has received the share of income from the family is a coparcener or not but he must be a member of that family at the time of receiving the money.

SHARE OF PROFIT FROM PARTNERSHIP FIRM [SECTION 10(2A)]

Share income of a person being a partner of a firm (includes Limited Liability Partnerships) which is separately assessed as such is exempt from tax. For the purposes of this clause, the share of a partner in the total income of a firm separately assessed as such shall be an amount which bears to the total income of the firm the same proportion as the amount of his share in the profits of the firm in accordance with the partnership deed bears to such profits.

INTEREST INCOME OF NON-RESIDENTS [SECTION 10(4)]

- (i) In the case of non-residents any income from interest on such securities or bonds as the Central Government may by notification in the Official Gazette specify in this behalf including income by way of premium on the redemption of such bonds.
- (ii) In the case of an individual, any income by way of interest on moneys standing to his credit in a Non-resident (External) Account in any bank in India in accordance with the Foreign Exchange Management Act, 1999 and the Rules made thereunder.

INTEREST INCOME OF NON-RESIDENTS FROM SPECIFIED SAVINGS CERTIFICATES [SECTION 10(4B)]

In the case of an individual being a citizen of India or a person of Indian origin, who is a non-resident, any income from interest on notified savings certificates issued before the 1st day of June, 2002 by the Central Government will be exempt provided he subscribes to such certificates in foreign currency or other foreign exchange remitted from a country outside India in accordance with the provisions of the Foreign Exchange Management Act, 1999 and any rules made thereunder. It is important to note that the exemption will be available only to the original subscribers to the savings certificates.

TRAVEL CONCESSION OR ASSISTANCE TO A CITIZEN OF INDIA [SECTION 10(5)]

The value of any travel Concession or assistance provided by the employer or the former employer to an Indian Citizen for himself and his family in connection with his proceeding to any place in India on leave or after retirement from service or after termination of his service is exempt subject to such conditions as may be prescribed having regard to travel concession or assistance granted to the employees of the Central Government. Provided that the amount exempt under this clause shall in no case exceed the amount of expenses actually incurred for the purpose of such travel.

The exemption is admissible in respect of actual expenditure incurred for journeys performed not only by himself (assessee) but also by his family.

For the purpose of this clause "family" means:

- (i) the spouse and children of the individual; and
- (ii) the parents, brothers and sisters of the individual or any of them, wholly or mainly dependent on him.

Rule 2B, provides that the value of travel concession or assistance received by or due to the individual from his employer or former employer for himself and his family, in connection with his proceeding:

- (a) on leave to any place in India;
- (b) to any place in India after retirement from service or after the termination of his service

The exemption can be availed only in respect of two journeys performed in a block of four calendar years. For this purpose, first four year block commenced from calendar year 1986 and the blocks work out as 1986-89, 1990-93, 1994-97, 1998-2001 and so on.

If travel concession or assistance is not availed during any of the four year block period, exemption can be claimed provided he avails the concession or assistance in the calendar year immediately following that block. This is popularly known as the 'carry-over' concession. In such cases, the exemption so availed will not be counted for purposes of regulating the future exemptions allowable for the succeeding block of four years.

Quantum of exemption is limited to the actual expenses incurred on the journey, i.e. without performing any journey and incurring expenses thereon, no exemption can be claimed.

Quantum of exemption is however subject to the following limits, depending upon the mode of transport used or available.

1. *For journey performed by air, air economy fare of the national carrier (Indian Airlines or Air India) by the shortest route to the place of destination.*
2. *Where place of origin of journey and destination are connected by rail and the journey is performed by any mode of transport other than by air, air-conditioned first class rail fare by the shortest route to the place of destination.*
3. *Where place of origin of journey and destination or part thereof are not connected by rail, the maximum amount shall be :*
 - (i) *where a recognised public transport system exists, the first class or deluxe class fare on such transport by the shortest route to the place of destination.*
 - (ii) *where no recognised public transport system exists, the air- conditioned first class rail fare, for the distance of the journey by the shortest route as if the journey has been performed by rail.*

EXEMPTIONS TO AN INDIVIDUAL WHO IS NOT A CITIZEN OF INDIA [SECTION 10(6)]

- (i) **Remuneration of Diplomats etc. [Section 10(6)(ii)]:** The remuneration received by him as an official, by whatever name called, of an embassy, high commission, legation, commission, consulate or the trade representation of a foreign State, or as a member of the staff of any of these officials, for service in such capacity:

However, the remuneration received by him as a trade commissioner or other official representative in India of the Government of a foreign State (not holding office as such in an honorary capacity), or as a member of the staff of any of those officials, shall be exempt only if the remuneration of the corresponding officials or, as the case may be, members of the staff, if any, of the Government of India, resident for similar purposes in the country concerned enjoys a similar exemption in that country.

that such members of the staff are subjects of the country represented and are not engaged in any business or profession or employment in India otherwise than as members of such staff.

- (ii) **Remuneration received by foreign individual [Section 10(6)(iv)]:** [The remuneration received by a foreign individual in his capacity as an employee of a foreign enterprise for the services rendered by him during his stay in India would be exempt if the following conditions are fulfilled:

- (a) The foreign enterprise is not engaged in any trade or business in India.
- (b) The total period of stay of the individual in India during the previous year does not exceed 90 days.
- (c) Such remuneration is not liable to be deducted from the income of the employer chargeable to tax in India under the Income-tax Act.

(iii) Non-resident employee on a foreign ship[Section 10(6)(vii)]: Income chargeable under the head 'Salaries' received by or due to any non-resident individual as remuneration for the services rendered by him in connection with his employment on foreign ship is exempt from tax where the total period of his stay in India does not exceed a period of 90 days during the previous year.

(iv) Remuneration of employee of foreign Government during his training in India [Section 10(6)(xi)]:

The remuneration received by an individual being a foreign citizen as an employee of the government of a foreign State during his stay in India in connection with his training in any establishment or office of, or in any undertaking owned by:

- (a) The government; or
- (b) Any company in which the entire paid-up capital is held by the Central Government, or any State Government or Governments; or partly by the Central Government and partly by one or more State Governments; or
- (c) Any company which is a subsidiary of a company referred to in (b); or
- (d) Any corporation established by or under a Central, State or Provincial Act; or
- (e) Any society registered under the Societies Registration Act, 1860, or under any other corresponding law for the time being in force and wholly financed by the Central Government, or any State Government or partly by the Central Government and partly by one or more State Governments.

TAX PAID ON BEHALF OF FOREIGN COMPANIES IN RESPECT OF CERTAIN INCOME [SECTION 10(6A)]

Under clause (6A), where income is derived by a foreign company by way of royalty or fees for technical services received from government or an Indian concern in pursuance of an agreement made by the foreign company with government or Indian concern after March 31, 1976 which is approved by the Central Government or where the agreement relates to matter included in the industrial policy of the government for the time being in force and tax on such income is payable, under the terms of such agreement by the government or the Indian concern to the Central Government, the tax so paid will not be included in computing the total income of the foreign company. This exemption is not available under Section 10(6A) if the agreement is entered into on or after 1.6.2002, as amended by Finance Act, 2002. In other words, the exemption is available for the agreements entered into up to 31.5.2002 only.

INCOME DERIVED BY A FOREIGN COMPANY [SECTION 10(6B)]

Clause (6B) provides that where in the case of non-resident (other than a company) or of a foreign company deriving income (other than salary, royalty or fees for technical services) from Government or an Indian concern in pursuance of an agreement entered into by the Central Government with the Government of a foreign State or an international organisation, the tax on such income is payable by Government or the Indian concern to the Central Government under the terms of that agreement or any other related agreement approved by the Central Government, the tax so paid shall be exempt. Finance Act, 2002 has provided that this exemption is not available under Section 10(6A) if the agreement is entered into on or after 1.6.2002. In other words, the exemption is available for the agreements entered into upto 31.5.2002 only.

INCOME OF FOREIGN AIRCRAFT BUSINESS FROM LEASE [SECTION 10(6BB)]

Any lease rental received by a government of a foreign state or a foreign enterprise from an Indian aviation company pursuant to an agreement made after 31st March, 1997 but before 1.4.99 or after 31st day of March 2007 and approved by the Central Government in this behalf will be exempt from tax if tax thereon is paid by the Indian company on behalf of the foreign government or foreign enterprise.

FEES FOR TECHNICAL SERVICES RECEIVED BY FOREIGN COMPANIES [SECTION 10(6C)]

Clause (6C) grants exemption to any income arising to the foreign companies notified by the Central Government by way of royalty or fees for technical services received pursuant to an agreement entered into with that Government for providing services in or outside India in projects connected with security of India.

ALLOWANCE PAYABLE OUTSIDE INDIA [SECTION 10(7)]

Allowances or perquisites paid or allowed as such outside India by the Central Government to a citizen of India for his services rendered outside India, would be wholly exempt from income-tax.

CO-OPERATIVE TECHNICAL ASSISTANCE PROGRAMMES [SECTION 10(8)]

In the case of an individual who is assigned duties in India in connection with co-operative technical assistance programmes and projects in accordance with an agreement entered into by the Central Government with the Government of a foreign State, the terms of which provide for the exemption from tax, the remuneration received by the individual directly or indirectly from the Government of that foreign State for such duties and any other income of such individual which accrues or arises outside India (but is not deemed to accrue or arise in India) and in respect of which such individual is required to pay any income-tax or social security tax to the Government of that foreign State, would be exempt from income-tax.

FEE RECEIVED BY CERTAIN CONSULTANTS OUT OF FUNDS MADE AVAILABLE TO INTERNATIONAL ORGANISATION [SECTION 10(8A)]

With effect from 1.4.1991 any remuneration or fee received by a consultant directly or indirectly out of the funds made available to an international organisation (hereafter called agency) under a technical assistance grant agreement between the agency and the Government of a foreign State and any other income which accrues or arises to the consultant outside India and is not deemed to accrue or arise in India in respect of which such consultant is required to pay any income tax or social security tax to the Government of the country of his or its origin, shall be exempt from income-tax.

For the purposes of this clause "consultant" means:

- (i) any individual who is either not a citizen of India, or being a citizen of India, is not ordinarily resident in India; or
- (ii) any other person being a non-resident engaged by the agency for rendering technical services in India in connection with any technical assistance programme or project provided the technical assistance is in accordance with an agreement entered into by the Central Government and the agency and that the agreement relating to the engagement of the consultant is approved by the prescribed authority for the purposes of this clause.

REMUNERATION RECEIVED BY CERTAIN INDIVIDUAL IN CONNECTION WITH ANY TECHNICAL ASSISTANCE PROGRAMME [SECTION 10(8B)]

Clause 8B inserted by the Finance (No. 2) Act, 1991 grants exemption w.e.f. 1.4.91 to an individual who is assigned to duties in India in connection with any technical assistance programme or project in accordance with an agreement entered into by the Central Government and the international organisation (hereinafter referred to as the agency) from:

- (a) the remuneration received by him directly or indirectly, for such duties from any consultant referred to above [i.e. in Section 10(8A)] and
- (b) any other income of such individual which accrues or arises outside India, and is not deemed to accrue or arise in India,

in respect of which such individual is required to pay any income tax or social security tax to the country of his origin, provided:

- (i) the individual is an employee of the consultant as defined in Section 10(8A) and is either not a citizen of India or, being a citizen of India is not ordinarily resident in India, and
- (ii) the contract of service of such individual is approved by the prescribed authority before the commencement of his service.

INCOME OF ANY MEMBER OF THE FAMILY [SECTION 10(9)]

The income of any member of the family of any such individual referred to in the preceding Clauses 8, 8A & 8B of Section 10, accompanying him to India which accrues or arises outside India and is not deemed to accrue or arise in India, is also exempt from tax provided that the member is required to pay any income-tax or social security tax to the Government of that foreign State on such income or as the case may be to the country of origin of such member.

DEATH-CUM-RETIREMENT GRATUITY [SECTION 10(10)]

Fully Exempted

The amount of any death-cum-retirement gratuity received under:

- (i) the revised pension rules of the Central Government; or
- (ii) the Central Civil Services (Pension) Rules, 1972; or
- (iii) any similar scheme applicable to (a), the members of civil services of the Union, or (b) holders of posts connected with defence or of civil posts under the Union, or (c) the member of All India Services, or (d) the members of civil services of a State, or (e) holders of civil posts under a State, or (f) employees of a local authority, or (g) Pension Code or Regulations applicable to the members of the defence services.

is wholly exempt from tax under Section 10(10)(i) of the Act.

The payment of gratuity by the Life Insurance Corporation of India under the Staff Regulations is wholly exempt from tax under Section 10(10), as the object and purpose of the gratuity scheme of the Life Insurance Corporation of India and the Revised Pension Rules of the Central Government are the same.

Illustration: *Mr. A, an employee of the Central Government, receives ₹ 1,00,000 as gratuity at the time of his retirement on May 1, 2013 under the new pension code. Determine the taxability of the gratuity in his hands for the assessment year 2014-15. In case he joins a private sector company on July 1, 2013 as its Managing Director, will it make any difference?*

Solution: Gratuity received by Mr. A shall be fully exempt from tax under Section 10(10)(i) of the Income-tax Act, 1961 as he is an employee of Central Government. Even if he joins a private sector company after the retirement, the aforesaid exemption shall still be available to him.

Conditions based Exemption

(i) Where the employees are covered under the Payment of Gratuity Act, 1972:

The amount of any gratuity received under The Payment of Gratuity Act, 1972, it shall be exempt from tax to the extent of least of the following:

- (a) fifteen days' wages (seven days' wages in case of seasonal establishments) for each completed year of service or part thereof in excess of six months on the basis of salary last drawn for every completed year of service or part thereof in excess of six months; or

- (b) the gratuity actually received; or
- (c) ₹ 10,00,000 (limit raised by notification no.43/2010 dt.11-06-2010)

Important Notes

(i) "Wages" means all emoluments which are earned by an employee while on duty or on leave in accordance with the terms and conditions of his employment and which are paid or are payable to him in cash and include dearness allowance but do not include any bonus, commission, house rent allowance, overtime wages and any other allowance.

(ii) **The Supreme Court has held that wages of fifteen days or seven days, as the case may be, will be calculated by dividing the wages last drawn by 26, i.e. maximum number of working days in a month [Digvijay Woollen Mills Ltd. v. Mahendra Prataparai Buch (1980) 4 Taxman 15].**

Illustration

Mr. B is employed in a non-seasonal factory at a salary of ₹ 2,400 P.M. Besides, he also gets dearness allowance @ ₹ 600 P.M. and bonus @ ₹ 200 P.M. He retires on December 31, 2013 and gets ₹ 75,000 as gratuity under the Payment of Gratuity Act after serving 31 years and 4 months in that factory. Compute the amount of gratuity which is exempt under the Income-tax Act, 1961.

Solution

In this case 31 years shall be taken as completed years of service.

15 days' salary is ₹ 1,730.77 (i.e. ₹ 3,000 × 15 ÷ 26)

Out of ₹ 75,000 received as gratuity, the least of the following will be exempt from tax:

- (i) ₹ 53,654 (being 15 days salary for each completed year of service i.e. ₹ 1,730.77 × 31);
- (ii) ₹ 10,00,000; or
- (iii) ₹ 75,000 (being gratuity actually received).

Hence, ₹ 53,654 being the least, is exempt from tax and the balance ₹ 21,346 is taxable for the assessment year 2014-15.

(ii) Where the employees are not covered under the Payment of Gratuity Act, 1972:

The amount of any other gratuity received by the employee from a private employer on his retirement or at the termination of his employment or on his becoming incapacitated or received by the employee's nominee on the former's death, to the extent it does not, in either case,

- (i) exceed one-half month's salary for each year of completed service, calculated on the basis of the average salary for the ten months immediately preceding the month in which any such event occurs or
- (ii) ten lakhs rupees* or
- (iii) gratuity actually received Where gratuities are received by the employee from more than one employer in the same previous year, the aggregate amount exempt from income-tax under (c) shall not exceed ₹10,00,000.*

Important Notes:

(i) Where any gratuity/gratuities was/were received in any one or more earlier previous years also and the whole or any part of the amount of such gratuity was not included in the total income of the assessee, the limit of ₹ 10,00,000* will be reduced by the amount of gratuity which has been exempted earlier.

* The limit has been raised to ₹ 10,00,000 vide Notification No. 43/2010 dated 11.06.2010 for employees who retire/die on or after 24.05.2010. Earlier the limit was ₹ 3,50,000.

(ii) 'Salary' includes dearness allowance, if the terms of employment so provide, but excludes all other allowances and perquisites. Where an employee receives dearness pay, it shall be included in the salary.

(iii) The Supreme Court has held that if under the terms of employment, commission is payable at a fixed percentage of turnover achieved by the employee such commission would partake of the character of 'Salary'. Therefore, salary will be basic salary, dearness allowance (forming part of salary for retirement benefits) and percentage commission.

(iv) "Year" means the calendar year commencing from the 1st of January and ending on the 31st December. "Each year of completed service" means a period of twelve months' service rendered by the employee, reckoned from the date on which he joined service with his employer.

Illustration

Mr. C, who is not covered by the Payment of Gratuity Act, received a gratuity of ₹ 90,000 on retirement on December 31, 2013 after serving 35 years (forms part of salary for retirement benefits) and 8 months. His last drawn emoluments were: Basic salary ₹ 4,000 p.m. Dearness allowance ₹ 1,000 p.m. Annual increment of ₹ 200 p.m. falls due on 1st October each year. Determine the amount of gratuity exempt from tax for the assessment year 2014-15.

Solution:

In this case 35 years shall be taken as completed years of service.

Average salary shall be computed as under:

Basic salary and D.A. drawn by him during:

(i) February 1, 2013 to September 30, 2013 @ ₹ 4,800

(i.e. ₹ 3,800 + ₹ 1,000) x 8 months =	₹ 38,400
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(ii) October 1, 2013 to November 30, 2013 @ ₹ 5,000

(i.e. ₹ 4,000 + ₹ 1,000) x 2 months =	₹ 10,000
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Total salary for 10 months	₹ 48,400
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Average salary p.m. = ₹ 48,400 ÷ 10	= ₹ 4,840
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Hence 1/2 month's average salary	= ₹ 4,840 ÷ 2
	= ₹ 2,420 p.m.

Out of ₹ 90,000 received as gratuity, the least of the following will be exempt from tax.

- (i) ₹ 84,700 (being 1/2 month's salary for each completed year of service i.e. ₹2,420 x 35);
- (ii) ₹ 10,00,000; or
- (iii) ₹ 90,000 (being gratuity actually received).

Hence, ₹ 84,700 being the least is exempt from tax and is not taxable for the assessment year 2014-15.

COMMUTATION OF PENSION [SECTION 10(10A)]

(i) Any payment in commutation of pension received under the Civil Pensions (Commutation) Rules or under any similar scheme applicable to Government employees is wholly exempt from tax.

(ii) Any lump sum received on commutation of pension by a Government servant absorbed in a public sector undertakings on or after July 24, 1971 also exempt from tax.

Judges of the Supreme Court and High Court and High Court will be entitled to the exemption of the computed portion U/s 10(10A) of the Act. (Circular No. 623, dated 6.1.1992)

(iii) Further, any payment in commutation of pension received by a person, under any scheme of any other employer, would be exempt to the extent it does not exceed:

- (a) in cases where the employee receives any gratuity; the commuted value of 1/3rd of pension which he is normally entitled to receive;
- (b) in any other case, the commuted value of 1/2 of such pension.

For this purpose, the commuted value should be determined having due regard to the age of recipient, the state of his health, the rate of interest and the officially recognised tables of mortality.

Illustration:

Mr. A is entitled to get a pension of ₹ 600 per month from a private company. He gets three-fifth of the pension commuted and receives ₹ 36,000. Compute the taxable portion of commuted value when:

- (a) he receives ₹ 20,000 as gratuity
- (b) he does not receive gratuity.

Solution:

	₹
Commuted value of 3/5 of pension	36,000
Commuted value of full pension i.e. $\left(\frac{5}{3} \times 36,000\right)$	60,000

(a) If Mr. A receives gratuity:

Amount exempt shall be one third of commuted value of full pension

$$= 1/3 \div 60,000 = ₹ 20,000$$

Commuted pension chargeable to tax as salary

$$= ₹ (36,000 - 20,000) = ₹ 16,000$$

(b) If Mr. A does not receive gratuity:

Amount exempt shall be one half of commuted value of full pension

$$= 1/2 \div 60,000 = ₹ 30,000$$

Commuted pension chargeable to tax as salary

$$= ₹ (36,000 - 30,000) = ₹ 6,000$$

(iv) Any payment in commutation of pension received from a pension fund set up by the Life Insurance Corporation of India in terms of Section 10(23AAB) is fully exempt from tax.

ENCASHMENT OF EARNED LEAVE [SECTION 10(10AA)]

Clause 10AA of Section 10 grants the following exemptions on this account:

- (i) Any payment received by an employee of the Central Government or a State Government as the cash equivalent of leave salary in respect of the period of earned leave at the employee's credit only at the time of retirement whether such retirement is on superannuation or otherwise. The effect of this clause is that payments received by an employee in respect of any period of leave not availed by him would be

chargeable to tax except, when such payments are made at retirement and qualify for exemption under Section 10(10AA) of the Act.

- (ii) Any payment as encashment of earned leave received from any other employer is exempt to the extent of:

For non-government employees (including employees of local authority or statutory corporation), least of the following:

- (i) Cash equivalent of the leave salary in respect of the period of earned leave standing to the credit of employee at the time of retirement/ superannuation (maximum earned leave entitlement being: 30 days for every year of actual service rendered for the employer from whose service he has retired); or
- (ii) 10 month's "average salary", i.e. salary drawn during the period of 10 months immediately preceding the retirement/superannuation, or

[Salary in this context, means, Basic salary and includes dearness allowance if terms of employment so provide. It also includes commission based on fixed percentage of turnover achieved by an employee as per terms of contract of employment *Gestetner Duplicators (P.) Ltd. v. C.I.T.* (1979) 117 ITR 1 (SC) but excludes all other allowances and perquisites].

- (iii) The amount specified by the Government. The maximum amount which is not chargeable to tax under Section 10(10AA) shall be ₹ 3,00,000.
- (iv) The amount of leave encashment actually received at the time of retirement.

Notes: (a) If the employee had received leave encashment in any one or more earlier previous year(s) also and had availed of the exemption in respect of such amount, then the limit in (iii) above, shall be reduced by the amount of exemption(s) availed earlier.

(b) Where the leave encashment is received by the employee from more than one employer in the same previous year, the specified limit in (iii) above would apply to the aggregate of leave encashment received from one or more employers.

(c) Leave salary received by the family of a government servant, who died in harness, is not taxable in the hands of the recipient. [Circular No. 309, dated 3.7.1981]

(d) Leave salary paid to legal heirs of a deceased employee in respect of privilege leave standing to the credit of such employee at the time of his death is an ex-gratia payment on compassionate grounds in the nature of gifts. Thus the payment is not in the nature of salary. [Letter No. 35/1/65, dated 5.11.1965]

(e) The assessee can claim relief from tax under section 89 in respect of leave encashment.

Illustration:

Mr. P, an employee of a company, receives ₹ 7,75,000 as leave salary at the time of his retirement on December 31, 2013. Determine the amount of taxable leave salary for the assessment year 2014-15 from the following information:

	₹
Salary at the time of retirement	25,000
Average salary received during last 10 months:	
– From March 1, 2013 to September 30, 2013	24,000
– From October 1, 2013 to December 31, 2013	25,000

Duration of Service	26 years
Leave entitlement for each year of service	1½ months
Leave availed while in service	8 months
Leave at the credit of employee at the time of retirement	
$(26 \times 1 \frac{1}{2} - 8)$	31 months
Leave salary paid at the time of retirement (i.e. ₹ 25,000 x 31)	7,75,000

Solution:

The amount of exemption under Section 10(10AA) of the Act shall be computed as under:

Leave entitlement @ one month leave for every year of service	26 months
Leave availed while in service	8 months
Leave standing to the credit of the employee at the time of retirement	18 months
Average salary of last 10 months ending on December 31, 2013 [i.e. (₹ 24,000 x 7 + ₹ 25,000 x 3) ÷ 10]	24,300

Out of ₹ 7,75,000 received as encashment of leave, the least of the following will be exempt from tax :

(i) Cash equivalent of leave to the credit of Mr. P at the time of retirement (i.e. ₹ 24,300 x 18)	4,37,400
(ii) 10 month's average salary (i.e. ₹ 24,300 x 10)	2,43,000
(iii) Amount specified by the Government	3,00,000
(iv) Amount received from the employer	7,75,000

Hence, ₹ 2,43,000, being the least, shall be exempt from tax under Section 10(10AA) of the Act and the balance ₹ 5,32,000 (i.e. ₹ 7,75,000 - 2,43,000) shall be taxable for the assessment year 2014-15.

RETRENCHMENT COMPENSATION [SECTION 10(10B)]

Any compensation received by a workman under the Industrial Disputes Act, 1947 or under any other Act or rules, orders or notifications issued thereunder or under any standing orders or under any award, contract of service or otherwise, at the time of his retrenchment. The amount is exempt under this clause to the extent of least of the following limits:

- (i) Actual amount received.
- (ii) Amount specified by Central Government i.e. ₹ 5,00,000.
- (iii) An amount calculated in accordance with the provisions of clause (b) of Section 25F of the Industrial Disputes Act, 1947 i.e. 15 day's average pay for every completed years of services or part thereof in excess of 6 months.

It may be noted that the above provision shall not apply in respect of any compensation received by a workman in accordance with any scheme which the Central Government may, having regard to the need for extending special protection to the workmen in the undertaking to which such scheme applies and, other relevant circumstances, approve in this behalf and the entire amount of compensation so received shall be exempt.

For this purpose retrenchment includes the closing down of the undertaking and transfer of the ownership or

management of the undertaking provided the service of the workman has been interrupted by transfer; or the new terms and conditions of service are less favourable to him; or the new employer is, under the terms of transfer or otherwise legally not liable to pay to the workman, in the event of his retrenchment, compensation on the basis that his service has been continuous and has not been interrupted by the transfer. "Wages", in the context of Section 10(10B), means:

- all remuneration capable of being expressed in terms of money, which would be payable to a workman in respect of employment or of work done in such employment, if the terms of employment, express or implied, were fulfilled.
- "Wages" also include (i) such allowances, including DA as the workman is entitled to; (ii) the value of any house accommodation, or supply of light, water, medical attendance or other amenity, or of any other service, concessional supply of foodgrains, or other articles; and (iii) any travel concession.
- However, "wages do not include: (i) any bonus; (ii) contribution to a retirement benefit scheme; (iii) any gratuity payable on the termination of his service.

Where retrenchment compensation received by a workman exceeds the amount which qualifies for exemption under the new clause, he will be entitled to relief under section 89 read with rule 21A of the Income Tax Rules, in respect of such excess.

COMPENSATION RECEIVED BY VICTIMS OF BHOPAL GAS LEAK DISASTER [SECTION 10(10BB)]

According to the clause any compensation received by victims of Bhopal Gas Leak Disaster under the Bhopal Gas Leak Disaster (Processing of Claims) Act, 1985 and any scheme framed thereunder is exempt from tax. This exemption of compensation received, however, would not be available to any assessee in connection with the Bhopal Gas Leak Disaster of an expenditure which has been incurred and allowed as a deduction from taxable income.

COMPENSATION RECEIVED BY VICTIMS ON ACCOUNT OF NATURAL DISASTER FROM CENTRAL GOVERNMENT [SECTION 10(10BC)]

Any amount received by the individual or legal heir by way of compensation from any disaster from Central Government, then, such income shall be exempt in the hands of individual or legal heir.

For this purpose, the expression "Disaster" shall have the meaning assigned to it under Section 2(d) of Disaster Management Act, 2005.

PAYMENT RECEIVED ON VOLUNTARY RETIREMENT [SECTION 10(10C)]

The amended provision provides for exemption of any amount received or receivable by an employee of a public sector company or of any other company or an authority established under Central, State or Provincial Act or a local authority, or any State Government or Central Government or the Institution having importance throughout India or a recognised management institute, on his voluntary retirement or termination of his service, in accordance with any scheme or schemes of voluntary retirement or in the case of a public sector company, a scheme of voluntary separation. The scheme of voluntary retirement are to be framed in accordance with such guidelines as may be prescribed which may include among other things the criteria of economic viability. The amount of exemption is the actual amount of compensation or ₹ 5,00,000, whichever is less. This exemption is available only once in the life time of an assessee.

The assessee shall not be eligible for relief under section 89 in case he has claimed exemption under section 10(10C). On the other hand, if he claims relief under section 89, he cannot claim exemption under section 10(10C).

TAX PAID BY THE EMPLOYER ON NON MONETARY PERQUISITES [SECTION 10(CC)]

According to Section 10(CC), in the case of an employee, being an individual deriving income in the nature of a perquisite, not provided for by way of monetary payment within the meaning of clause (2) of Section 17, the tax

on such income actually paid by his employer, on behalf of such employee, notwithstanding anything contained in Section 200 of the Companies Act, 1956, shall exempt.

PAYMENT RECEIVED UNDER A LIFE INSURANCE POLICY [SECTION 10(10D)]

Any sum received under a life insurance policy, including the sum allocated by way of bonus on such policy, other than –

- (a) any sum received under Sub-section (3) of Section 80DD or Sub-section (3) of Section 80DDA; or
- (b) any sum received under a Keyman insurance policy; or
- (c) any sum received under an insurance policy issued on or after the 1st day of April, 2003 but on or before 31st March 2012 in respect of which the premium payable for any of the years during the term of the policy exceeds twenty per cent of the actual capital sum assured; or
- (d) any sum received under an insurance policy issued on or after the 1st day of April, 2012 in respect of which the premium payable for any of the years during the term of the policy exceeds ten per cent of the actual capital sum assured.

Shall be exempt

However, provisions of this sub-clause (c) or (d) shall not apply to any sum received on the death of a person:

Provided further that for the purpose of calculating the actual capital sum assured under this sub-clause, effect shall be given to the Explanation to Sub-section (3) of Section 80C or the Explanation to Sub-section (2A) of Section 88, as the case may be.

Provided also that where the policy, issued on or after the 1st day of April, 2013, is for insurance on life of any person, who is –

- (i) a person with disability or a person with severe disability as referred to in section 80U; or
- (ii) suffering from disease or ailment as specified in the rules made under section 80DDB,

the provisions of this sub-clause shall have effect as if for the words “ten per cent”, the words “fifteen per cent” had been substituted.

“Keyman insurance policy” means a life insurance policy taken by a person on the life of another person who is or was the employee of the first-mentioned person or is or was connected in any manner whatsoever with the business of the first-mentioned person and includes such policy which has been assigned to a person, at any time during the term of the policy, with or without any consideration.

For the purposes of this sub-section, “actual capital sum assured” in relation to a life insurance policy shall mean the minimum amount assured under the policy on happening of the insured event at any time during the term of the policy, not taking into account –

- (i) the value of any premium agreed to be returned; or
- (ii) any benefit by way of bonus or otherwise over and above the sum actually assured, which is to be or may be received under the policy by any person.

PAYMENT FROM STATUTORY PROVIDENT FUND [SECTION 10(11)]

Any payment received from a provident fund to which the Provident Funds Act, 1925 applies or any other provident fund set-up by the Central Government and notified by it in the Official Gazette, would be exempt from tax without any monetary or other limits. The former is known as Statutory Provident Fund and the latter as Public Provident Fund. For Notified PPF, See Notification No. S.O. 2430 dated 2.7.1968 (1968) 69 ITR (ST) 24.

PAYMENT FROM A RECOGNISED PROVIDENT FUND [SECTION 10(12)]

The accumulated balance due and becoming payable to an employee participating in a recognised provident fund, would be exempt from tax if the following conditions are satisfied:

- (i) The employee has rendered continuous service with his employer for a period of 5 years or more; or
- (ii) Where he has not rendered such continuous service, the service has been terminated by reason of employee's ill-health or by the contraction or discontinuance of the employer's business or by any other cause beyond the control of the employee; or
- (iii) On cessation of his employment he obtains employment with any other employer and the balance standing in his Recognised Provident Fund is transferred to his account in a Recognised Provident Fund maintained by the new employer.

Where the accumulated balance of the fund has been transferred to any other such fund, then in computing the period of continuous service for clause (i) or clause (ii) the period or periods for which such employee rendered continuous service under his former employer or employers shall be included.

PAYMENT FROM AN APPROVED SUPERANNUATION FUND [SECTION 10(13)]

Any payment from an approved superannuation fund made:

- (i) on the death of the beneficiary; or
- (ii) to an employee in lieu of or in commutation of an annuity on his retirement at or after a specified age or on his becoming incapacitated prior to such retirement; or
- (iii) by way of refund of contributions on the death of the beneficiary; or
- (iv) by way of refund of contributions to an employee on his leaving the service in connection with which the fund is established otherwise than by retirement at or after a specified age or at his becoming incapacitated from service prior to such retirement to the extent to which such payment does not exceed the contributions made prior to the commencement of this Act, i.e., 1.4.1962, and also any interest thereon, would be wholly exempt from tax.

HOUSE RENT ALLOWANCE [SECTION 10(13A)]

Any special allowance specifically granted to an employee by his employer to meet expenditure actually incurred on payment of rent in respect of residential accommodation occupied by the assessee, is exempt to the extent of least of the following:

- (i) Actual amount of such allowance received in respect of the relevant period; or
- (ii) Rent paid over 10% of salary [Rent paid – 10% of salary]
- (iii) an amount equal to:
 - (a) where such accommodation is situated at Mumbai, Kolkatta, Delhi or Chennai, one-half of the amount of salary due to the assessee in respect of the relevant period; and
 - (b) where such accommodation is situated at any other place, two-fifth of the amount of salary due to the assessee in respect of the relevant period.

Salary = Basic Pay + D.A. (If form part of retirement benefit) + Commission (If it is based on specific % of turnover).

Explanation:

- (i) 'Relevant period' means the periods during which the said accommodation was occupied by the assessee during the previous year.
- (ii) 'Salary' includes Basic pay, dearness allowance, if the terms allow, includes commission, but excludes all other allowances and perquisites. However, the Supreme Court has held that commission to be paid to an employee at fixed percentage of turnover earned by him as salary. [Gestetner Duplicators (P) Ltd. v. C.I.T. (1979) 117 I.T.R. 1].

- (iii) By virtue of the Taxation Laws (Amendment) Act, 1984 applicable with retrospective effect from 1.4.1976, exemption is denied where an employee lives in his own house, or in a house for which he does not pay any rent or pays rent which does not exceed 10% of salary.

House rent allowance to High Court and Supreme Court Judges: Under their service conditions the house rent allowance paid to them is exempt from income-tax w.e.f. 1.4.1975.

Employees have to produce receipt for rent paid to satisfy the taxation authorities to substantiate his claim. However, this receipt is not required to be deposited by employees paying rent upto ₹ 3,000 per month. However it should be noted that non-production is only for the purpose of tax deduction. But at the time of assessment AO can ask to produce rent receipt. (Circular No. 9/2003, 18.11.2003).

Illustration:

Mr. G who lives in Lucknow, gets the following emoluments during the previous year ended on March 31, 2014.

Emoluments of 10 months from X Ltd.: Basic Salary ₹ 5,000 P.M. dearness pay forming part of the basic pay ₹ 500 P.M. and house rent allowance ₹ 1,000 P.M.

Emoluments of 2 months from Y Ltd.: Basic salary ₹ 6,000 P.M.; house rent allowance ₹ 2,500 P.M. and ₹ 20,000 being Commission @ 2% of sales achieved by Mr. G (Sales target achieved by him was ₹ 10,00,000 during this period).

One month salary due from Y Ltd. during 2012-13 is received by him in April 2013. He pays ₹ 3,000 per month as house rent through out the previous year. Determine the amount of house rent allowance chargeable to tax for the assessment year 2014-15.

Solution:

X Ltd.: House rent allowance, exempt from tax, shall be the least of the following:

- (i) ₹ 2,200 per month (being 40% of salary i.e. ₹ 5,000 + ₹ 500);
 - (ii) ₹ 1,000 per month (being the actual HRA);
 - (iii) ₹ 2,450 per month [Being the excess of rent paid over 10% of salary i.e. ₹ (3,000 – 550) per month].
- ₹ 1,000 per month, being the least shall be exempt from tax.

Y Ltd.: Salary for the purpose of computation of exempt HRA works out to ₹ 16,000 per month as below:

	₹
Basic salary per month	6,000
Commission of one month (i.e. 2% of ₹ 10,00,000 ÷ 2) to be included as per ruling of the Supreme Court in the case of Gestetner Duplicators (P) Ltd. v. CIT	10,000
Total	16,000

House rent allowance, exempt from tax, shall be the least of the following:

- (i) ₹ 6,400 per month (being 40% of salary)
 - (ii) ₹ 2,500 per month (being the actual HRA);
 - (iii) ₹ 1,400 per month [Being the excess of rent paid over 10% of salary i.e. ₹ (3,000 – 1,600) per month].
- ₹ 1,400 per month, being the least shall be exempt from tax.

Amount to be included in taxable salary income of Mr. G

X Ltd. (₹ 1,000 – 1,000) x 10	NIL
Y Ltd. (₹ 2,500 – 1,400) x 2	2,200
Total	

Note: The exemption in respect of HRA is based upon the following factors:

- (1) Basic Salary
- (2) Place of Residence
- (3) Rent paid
- (4) HRA received

Since there is a possibility of change in any of the above factors during the previous year, exemption for HRA should not always be calculated on annual basis. As long as there is no change in any of the above factors it can be calculated together for that period. Whenever there is a change in any of the above factors, it should be separately calculated till the next change.

SPECIAL ALLOWANCE [SECTION 10(14)]

(a) Any special allowance in cash or the value of any benefit granted by the employer to an employee with the specific object of enabling the employee to meet expenses 'wholly', 'necessarily' and 'exclusively' incurred by him in the performance of the duties of his office or employment of profit, is exempt from tax to the extent to which such expenses are actually incurred for that purpose. This allowance may include travelling allowance to agents, conveyance allowance, transfer allowance, etc., but it does not include entertainment allowance, perquisites and the allowance to meet personal expenses (i.e. City Compensatory Allowance) at the place where the duties of office are performed by him or at the place where he ordinarily resides [Addl. C.I.T. v. A.K. Mishra 117 ITR 342 (All.)].

It must be noted that to be eligible for exemption the amount must have been actually expended. Where a surplus remains in the hands of the assessee out of a lump sum paid to him by the employer for the purpose, the surplus would be taxable in the hands of the assessee as income. This is irrespective of the fact that the employer does not demand refund of the amount not expended [CIT v. Tejaji Farasram Kharawalla Ltd. (1968) 67 ITR 95 (SC)].

(b) The allowances granted to the assessee to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at the place where he resides, or to compensate him for the increased cost of living, as the Central Government may, by notification in the Official Gazette specify, shall not form part of the total income of the assessee to such notified extent.

(c) The types of and the extent to which the allowances were exempt were hitherto notified by the Central Government in terms of the power delegated to it under Section 10(14) of the Act. The Finance Act, 1995, has with effect from 1st July, 1995, delegated this power to the Central Board of Direct Taxes with a view to enabling it to make necessary rules in this regard so that all the exemptions can be found at one place under the relevant rule instead of one having to look at all the notifications issued by the Central Government from time to time. Accordingly, the CBDT has inserted a new rule 2BB to the Income-tax Rules, 1962, w.e.f. 1st July, 1995 which is reproduced below for easy reference:

Rule 2BB. Prescribed allowances for the purposes of clause (14)(i) of Section 10 - For the purposes of sub-clause (i) of clause (14) of Section 10, prescribed allowances, by whatever name called, shall be the following, namely –

- (a) any allowance granted to meet the cost of travel on tour or on transfer;
- (b) any allowance, whether granted on tour or for the period of journey in connection with transfer, to meet the ordinary daily charges incurred by an employee on account of absence from his normal place of duty;
- (c) any allowance granted to meet the expenditure incurred on conveyance in performance of duties of an office or employment of profit;

Provided that free conveyance is not provided by the employer;

- (d) any allowance granted to meet the expenditure incurred on a helper where such helper is engaged for the performance of the duties of an office or employment of profit;
- (e) any allowance granted for encouraging the academic, research and training pursuits in educational and research institutions;

- (f) any allowance granted to meet the expenditure incurred on the purchase or maintenance of uniform for wear during the performance of the duties of an office or employment of profit.

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

(2) For the purposes of sub-clause (ii) of clause (14) of Section 10, the prescribed allowances, by whatever name called, and the extent thereof shall be following, namely -

Sl. No.	Name & Nature of allowance	Extent to which allowance is exempt
1.	Any special compensatory allowance in the nature of composite hill compensatory allowance or high altitude allowance or uncongenial climate allowance or snow bound area allowance or avalanche allowance	₹800 per month or ₹7,000 per month or ₹300 per month depending upon the specified locations
2.	Any Special Compensatory Allowance in the Nature of Border Area Allowance, Remote Locality Allowance or Difficult Area Allowance or Disturbed Area Allowance	₹1,300 per month or ₹1,100 per month or ₹1,050 per month or ₹ 750 per month or ₹300 per month or ₹200 per month depending upon the specified locations
3.	Tribal area allowance	₹200 per month
4.	Any allowance granted to an employee working in any transport system to meet his personal expenditure during his duty performed in the course of running of such transport from one place to another place, provided that such employee is not in receipt of daily allowance	70 per cent of such allowance upto a maximum of ₹6,000 per month
5.	Children education allowance	₹100 per month per child up to a maximum of two children
6.	Any allowance granted to an employee to meet the hostel expenditure on his child	₹300 per month per child up to a maximum of two children
7.	Compensatory field area allowance	₹2,600 per month
8.	Compensatory modified field area allowance	₹1,000 per month
9.	Any special allowance in the nature of counter insurgency allowance granted to the member of armed forces operating in areas away from their permanent locations for a period of more than 30 days.	₹ 3,900 per month
10.	Transport allowance granted to an employee to meet his expenditure for the purpose of commuting between the place of his residence and the place of his duty.	₹ 800 per month
11.	Transport allowance granted to an employee, who is blind or orthopedically handicapped with disability of lower extremities, to meet his expenditure for the purpose of commuting between the place of his residence and the place of his duty	₹ 1600 p.m.
12.	Underground allowance	₹ 800 p.m.

Provided that any assessee claiming exemption in respect of the allowances mentioned at serial numbers 7 and 8 shall not be entitled to the exemption in respect of the allowance referred to at serial number 2.

Provided further that any assessee claiming exemption in respect of the allowance mentioned at serial number 9 shall not be entitled to the exemption in respect of disturbed area allowance referred to at serial number 2.

Interest from certain Investments [Section 10(15)]

The interest income from the following securities would be exempt from tax, to the extent to which amount of these certificates and deposits do not exceed, in each case, the maximum amount permitted to be invested or deposited therein.

- (i) Income by way of interest, premium on redemption or other payments on notified bonds, securities, or certificates issued by the Government and interest on notified deposits.

The notified securities/bonds, etc., are: 12 year National Savings Annuity Certificates; National Defence Gold Bonds, 1980; Special Bearer Bonds, 1991; Treasury Savings Deposits Certificates (10 years); Post Office Cash Certificates (5 years); National Plan Certificates (10 years); National Plan Savings Certificates (12 years); Post Office National Savings Certificates (12 years/7 years); Post Office Savings Banks Accounts; Public Account of Post Office Savings Account Rules (interest up to ₹ 5,000); Post Office CTD; Fixed Deposit [Government Savings Certificates (Fixed Deposit) Rules, 1968 or Post Office (Fixed Deposit) Rules, 1968]; and Special Deposit Scheme, 1981.

- (ii) Interest on 7 per cent Capital Investment Bonds in the case of individual and Hindu undivided families specified up to 31-5-2002 only.
- (iii) Interest on 9 per cent Relief Bonds, with effect from 1.1.99 (Prior to that it was 10% relief bond), in the case of an individual and Hindu undivided family.
- (iv) Interest received by a non-resident Indian from notified bonds (i.e., NRI Bonds, 1988, issued by State Bank of India), NRI Bonds (Second Series) issued by State Bank of India or by an individual owning such bonds by virtue of being a nominee or survivor of such non-resident Indian or by an individual to whom the bonds have been gifted by the non-resident Indian (applicable from the assessment year 1989-90). [Exemption will be available only if the bonds are purchased by a non-resident Indian in foreign exchange. The interest and principal received in respect of such bonds whether on their maturity or otherwise, is not allowable to be taken out of India. Where the individual who is a non-resident Indian in the previous year in which the bonds are acquired, becomes a resident in India in any subsequent year the interest received from such bonds will continue to be exempt in the subsequent years as well].

If the bonds are encashed in a previous year prior to their maturity by an individual who is so entitled, the exemption in relation to the interest income shall not be available to such individual in the assessment year relevant to such previous year in which the bonds have been encashed specified up to 31-5-2002 only.

- (v) Interest on securities held by the Issue Department of the Central Bank of Ceylon.
- (vi) Interest payable to any foreign bank performing central banking functions outside India (This exemption will be available from the assessment year 1985-86 where the interest is payable in respect of the deposits made by such bank with any scheduled bank in India with the approval of the Reserve Bank of India).
- (via) Interest payable to European Investment Bank, on a loan granted by it in pursuance of the framework agreement for financial co-operation entered on the 25th day of November, 1993 by the Central Government with that Bank.
 - (a) Interest payable by the Government or a local authority on moneys borrowed by it before the 1st

day of June, 2001 from, or debts owned by it before the 1st day of June, 2001 to sources outside India.

- (b) Interest payable by an industrial undertaking on moneys borrowed by it under a loan agreement entered into before 1st day of June 2001 with any such financial institution in a foreign country as may be approved in this behalf by the Central Government by general or special order. The International Finance Corporation, Washington; Export Import Bank of Washington, Washington, D.C.; Export Import Bank of Japan, Tokyo; The Development Loan Fund, Columbia, U.S.A.; The West German Bank for Reconstruction, West Germany and the Banque Francaise de Commerce Exterior, Paris.
- (c) Interest payable by an industrial undertaking in India on any moneys borrowed or debt incurred by it before the 1st day of June, 2001 in a foreign country in respect of purchase outside India of raw materials, or components, or capital plant and machinery to the extent to which such interest does not exceed the amount of interest calculated at the rate approved by the Central Government in this behalf, having regard to the terms of the loan or debt and its repayment. With effect from the assessment year 1983-84, the scope of the exemption is extended to include purchase of capital plant and machinery under hire-purchase agreement or a lease agreement with an option to purchase such plant and machinery.
- (d) Interest payable by the Industrial Finance Corporation of India or the Industrial Development Bank of India or the Industrial Credit and Investment Corporation of India, or Export Import Bank of India or the National Housing Bank or the Small Industries Development Bank of India on any moneys borrowed from sources outside India before the 1st day of June, 2001 to the extent such interest does not exceed the interest calculated at the rate approved by Central Government.
- (e) Interest payable by any other financial institution established in India or a banking company on any moneys borrowed before the 1st day of June, 2001 from sources outside India under an approved loan agreement to the extent it does not exceed the rate approved by Central Government.
- (f) Interest payable by an industrial undertaking in India on any moneys borrowed by it in a foreign currency from sources outside India under an approved loan agreement before the 1st day of June, 2001.
- (fa) Interest payable by a schedule bank, to a non-resident or to a person who is not ordinarily resident within the meaning of Section 6 on deposit in foreign currency where acceptance of such deposits by the bank is approved by the Reserve Bank of India.
- (g) Interest payable by a public company formed and registered in India, and eligible for deduction under Section 36(1)(viii), with the main objective of carrying on business of providing long-term finance for construction or purchase of houses in India for residential purposes on any moneys borrowed by it in foreign currency from sources outside India under an approved loan agreement, to the extent to which such interest does not exceed the amount of interest calculated at the rate approved by the Central Government before 1st day of June 2003.
- (h) Interest payable by public sector companies on certain specified bonds and debentures subject to such conditions, including the condition that the holder of such bonds or debentures registers his name and his holding with that company, as may be specified by the Central Government by notification in the Official Gazette.
- (i) Interest on deposits, with a notified scheme, made by a retiring Government employee (or public sector employee, with effect from the assessment year 1991-92) out of his retirement benefits for a lock-in-period of three years.

Explanation 1: For the purpose of these sub-clauses, the expression "industrial undertaking" means any undertaking which is engaged in –

- (a) the manufacture or processing of goods; or
- (aa) the manufacture of computer software or recording of programmes on any disc, tape, perforated media or other information device; or
- (b) the business of generation or distribution of electricity or any other form of power; or
- (ba) the business of providing telecommunication services; or
- (c) mining; or
- (d) the construction of ships; or
- (e) the operation of ships or aircrafts or construction or operation of rail systems.

Explanation 1A: For the purposes of this sub-clause, the expression "interest" shall not include interest paid on delayed payment of loan or on default if it is in excess of two per cent per annum over the rate of interest payable in terms of such loan.

Explanation 2: For the purpose of this clause, the expression 'interest' includes hedging transaction charges on account of currency fluctuations.

- (vii) Interest on securities held by the Welfare Commissioner, Bhopal Gas Victims, Bhopal and interest on deposits for the benefit of the victims of the Bhopal gas leak disaster held in such account with the Reserve Bank of India or with a Public Sector Bank, as the Central Government may notify.
- (viii) Interest on Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 notified by the Central Government.
- (ix) Interest on bonds -
 - (a) issued by a local authority; and
 - (b) Specified by the Central Government by notification in the Official Gazette.

Where investments are made by an assessee in the names of wife and minor children, the exemption from income-tax is allowed upto the limit of the maximum amount that may be invested in their names in the tax-free savings certificates. Similarly, in the event of death of a joint holder of the certificates the surviving joint holder would continue to get exemption from tax on the interest received upto the maximum amount permitted to be held in the case of joint holdings.

Lease rent for leasing of an aircraft [Section 10(15A)]

Any payment made, by an Indian company engaged in the business of operation of aircraft, to acquire an aircraft or an aircraft engine (other than a payment for providing spares, facilities or services in connection with the operation of the leased aircraft) on lease from the Government of a foreign State or a foreign enterprise under an agreement entered into not being an agreement entered into between the 1st day of April, 1997 and the 31st day of March, 1999 and approved by the Central Government, shall be exempt in the hands of such foreign Government or foreign enterprise.

No exemption under this clause shall be available where any such agreement entered into on or after 1st day of April 2007.

Scholarships [Section 10(16)]

Scholarships granted to meet the cost of education would be exempt in every case regardless of the residential status or citizenship of the scholar and the person from whom the scholarships are received.

Daily Allowances of MPs and MLAs [Section 10(17)]

The provisions in this regard are as follows:

Any income by way of:

- (i) daily allowance received by any person by reason of his membership of Parliament or of any State legislature or of any Committee thereof;
- (ii) any allowance received by any person by reason of his membership of Parliament under the Members of Parliament (Constituency Allowance) Rules, 1986;
- (iii) any constituency allowance received by any person by reason of his membership of any State Legislature under any Act or rules made by that State Legislation.

Awards/Rewards [Section 10(17A)]

Any payments made, whether in cash or in kind, in pursuance of any award instituted in the public interest by the Government or instituted by any other body and approved by the Central Government or as a reward by the Government for such purposes as may be approved by the Central Government in the public interest shall be exempt.

Pension [Section 10(18)]

A new clause 10(18) has been inserted by Finance Act, 1999 with effect from 1.4.2000 to provide that any income by way of pension received by an individual or family pension received by any member of the family of such individual shall be exempt if such individual has been in the service of Central/State Government and has been awarded Param Vir Chakra or Maha Vir Chakra or Vir Chakra or such other gallantry award as may be notified.

Family Pension [Section 10(19)]

Family pension received by the widow or children or nominated heirs, as the case may be, of a member of the armed forces (including paramilitary forces) of the Union, where the death of such member has occurred in the course of operational duties, in such circumstances and subject to such conditions, as may be prescribed, shall be exempt from tax. However, family pension received by others is exempt upto least of ₹15,000 or 1/3rd of family pension and it is taxable under the head other sources.

Annual Value of Palace of a Ruler [Section 10(19A)]

The annual value of any one palace in the occupation of a Ruler would be exempt if it was exempt from income-tax before the commencement of the Constitution Twenty-Sixth (Amendment) Act, 1971 by virtue of the provisions of the Merged States (Taxation Concessions) Order, 1949 or any other taxation concession order. Annual value of the entire building is exempt even though a portion only is occupied by the ruler [C.I.T. v. Bharat Chandra (H.C.) M.P. (1985) Tax. 77].

Income of Local Authorities [Section 10(20)]

The income of a local authority which is chargeable under the head 'Income from house property', 'Capital gains' or 'Income from other sources' or even from a trade or business carried on by it which accrues or arises from the supply of commodities or services (other than water or electricity) within its own jurisdictional area or from the supply of water or electricity within or outside its own jurisdictional area would be wholly exempt from income-tax.

Income of Research Associations [Section 10(21)]

Any income of a Research Association, approved for the purposes of Section 35(1)(ii)(iii) shall be exempt from tax if the Research Association applies its income or accumulates it for application, wholly and exclusively, to the objects for which it is established and the provisions of Section 11(2) and (3) shall be applicable to such accumulations with due adaptations for the purposes of scientific research or research in social science or statistical research and it does not invest or deposit its funds, other than -

- (i) any assets held by the research association where such assets form part of the corpus of the fund of the association as on the first day of June, 1973;
- (ii) any assets (being debentures issued by or on behalf of, any company or corporation) acquired by the research association before the 1st day of March, 1983;
- (iii) any accretion to the shares forming part of the corpus of the fund mentioned in sub-clause (i) by way of bonus shares allotted to the research association;
- (iv) voluntary contribution received and maintained in the form of jewellery, furniture or any other article as the Board may by notification in the official gazette, specify,

for any period during the previous year otherwise than in the forms and modes as specified in Section 11(5).

However, the exemption under this clause shall not be denied in relation to voluntary contribution, other than voluntary contribution in cash or voluntary contribution of the nature referred to (i), (ii), (iii) and (iv) above, subject to condition that such voluntary contribution is held by the research association only in the forms or modes as specified in Section 11(5) after the expiry of one year from the end of the previous year in which such asset is acquired or the 31st day of March, 1992 whichever is later.

Further, the exemption under this clause to any profits and gains of business carried on by the research association shall be available if the business is incidental to the attainment of its objectives and separate books of account are maintained in respect of such business.

Also, the exemption under this clause shall be withdrawn if the Central Government is satisfied that the conditions are not being fulfilled but an opportunity of being heard shall be provided.

Income of News Agency [Section 10(22B)]

With effect from assessment year 1994-95, income of a news agency set up in India solely for collection and distribution of news will be exempt subject to the conditions that - (a) the news agency is notified for this purpose by the Central Government; (b) it applies its income or accumulates it for application solely for collection and distribution of news; and (c) it does not distribute its income in any manner to its members.

Provided also that where the news agency has been specified, by notification, by the Central Government and subsequently that Government is satisfied that such news agency has not applied or accumulated or distributed its income in accordance with the provisions contained in the first proviso, it may, at any time after giving a reasonable opportunity of showing cause, rescind the notification and forward a copy of the order rescinding the notification to such agency and to the Assessing Officer.

Income of a Professional Institution [Section 10(23A)]

Any income of an association or body or institution established in India having as its object the control, supervision, regulation or encouragement of the profession of law, medicine, accountancy, engineering or architecture or such other profession as the Central Government may specify in this behalf from time to time by notification in the Official Gazette, would be exempt from tax if the association or institution applies its income or accumulates it for application solely to the objects for which it is established and the institution or association is for the time being approved by the Central Government for this purpose by a general or special order. This tax exemption would not, however, be available to the professional bodies in respect of their income under the head 'Income from house property' or 'Income received for rendering any specific service' or 'Income by way of interest or dividends derived from its investments'.

Further, the exemption under this clause shall be withdrawn if Central Government is satisfied that conditions are not being fulfilled.

Income of a Regimental Fund or Non-Public Fund [Section 10(23AA)]

Income derived by any Regimental Fund or Non-Public Fund established by the armed forces of the Union for the welfare of their past and present members and their dependents will be exempt from tax.

Exemption to fund established for welfare of employees [Section 10(23AAA)]

With effect from the assessment year 1996-97 a new clause (23AAA) has been inserted in Section 10. It provides for exemption from tax on any income received by any person on behalf of a fund, established for such purposes as may be notified by the Board, for the welfare of employees or their dependents and of which fund such employees are members. The exemption will be available only if the fund applies its income, or accumulates it for application, wholly and exclusively, to the objects for which it is established. The aforesaid fund shall invest its funds and contributions made by the employees and other sums received by it in any one or more of the forms or modes specified in Section 11(5). The said fund is to be approved by the Commissioner in accordance with the rules made in this behalf and such approval shall have effect for such assessment year or years not exceeding three assessment years as may be specified in the order of approval.

Pension fund of LIC [Section 10(23AAB)]

The Income of the Life Insurance Corporation of India or any other insurer to the extent it is from a fund set up under a pension scheme to which contribution is made by any person for receiving pension from such fund is exempt from tax provided the pension scheme is approved by the Controller of Insurance or the Insurance Regulatory and Development Authority established under Sub-section (1) of Section 3 of the Insurance Regulatory and Development Authority Act, 1999, as the case may be.

Income of an Institution established for promoting Khadi and Village Industries [Section 10(23B)]

Any income of an institution constituted as a public charitable trust or registered under the Societies Registration Act, 1860, or under any law corresponding to that Act in force in any part of India and existing solely for the development of Khadi or Village industries or both, and not for purposes of profit, to the extent such income is attributable to the business of production, sale or marketing of Khadi or products of village industries, is exempt from tax if the institution applies its income or accumulates it for application solely to the development of Khadi or Village industries or both and the institution is for the time being approved by the Khadi and Village Industries Commission.

Provided that the commission shall not at any time grant such approval for more than three assessment years, beginning with the assessment year next following the financial year in which it is granted.

Further, the exemption under this clause shall be withdrawn if Central Government is satisfied that conditions are not being fulfilled after giving an opportunity of being heard.

Income of Khadi and Village Industries Board established by a State Act [Section 10(23BB)]

Any income of an authority (whether known as Khadi and Village Industries Board or by any other name) established in any State by or under a State or Provincial Act for the development of Khadi and Village Industries in the State is exempt from tax. ['Khadi' and 'Village Industries' have the same meaning assigned to them in the 'Khadi and Village Industries Commission Act, 1956' (61 of 1956)].

Income of Statutory Authority Administering Charitable Trust etc. [Section 10(23BBA)]

Any income of any body or authority whether or not body corporate or corporation solely established, constituted or appointed by or under any Central, State or Provincial Act which provides for the administration of any one or more of the following, that is to say, public religious or charitable trusts or endowments (including maths, temples, Gurudwaras, wakfs, churches, synagogues, agiaries or other places of public religious worship) or societies for religious or charitable purposes registered as such under the Societies Registration Act, 1860 or any other law

for the time being in force, provided nothing aforesaid shall be construed to exempt from tax the income of any trust, endowment or society referred to therein.

Income of European Economic Community [Section 10(23BBB)]

Any income of the European Economic Community derived in India by way of interest, dividend or capital gains from investments made out of its funds under such scheme as the Central Government may specify in this behalf.

A new clause (23BBC) is inserted in Section 10 so as to provide exemption from income-tax of any income derived by the SAARC Fund for Regional Projects which was set up by Colombo Declaration issued on 21st December, 1991 by the Heads of State or Government of the Member-countries of South Asian Association for Regional Corporation established on 8th December, 1985 by the Charter of the South Asian Association for Regional Corporation.

Income of SAARC Fund [Section 10(23BBC)]

Any income of the South Asian Association for Regional Cooperation Fund for Regional Projects set-up by the Colombo Plan Declaration shall be exempt.

Income of ASOSAI-SECRETARIAT [Section 10(23BBD)]

Any income of the Secretariat of the Asian Organisation of the Supreme Audit Institutions which has been registered as ASOSAI-SECRETARIAT under the Societies Registration Act, 1860 shall be exempt from tax for ten previous years relevant to the assessment years beginning on the 1st day of April 2001 and ending on the 31st day of March 2011.

Income of IRDA [Section 10(23BBE)]

Any income of Insurance Regulatory and Development Authority established under Section 3(1) of IRDA Act, 1999 shall be exempt from tax from the Assessment Year 2001-02.

Income of Prasar Bharati (Broadcasting Corporation of India) [Section 10(23BBH)]

With effect from assessment year 2013-14, Clause (23BBH) has been inserted in section 10 to exempt any income of the Prasar Bharati (Broadcasting Corporation of India) established under section 3(1) of the Prasar Bharati (Broadcasting Corporation of India) Act, 1990.

Any Income Received by any Person on behalf of certain Persons [Section 10(23C)]

The income received by any person on behalf of the following are exempt from tax:

- (i) the Prime Minister's National Relief Fund; or
- (ii) the Prime Minister's Fund (Promotion of Folk Art); or
- (iii) the Prime Minister's Aid to Students Fund; or
- (iiia) the national foundation for communal harmony.
- (iiib) any university or other educational institution existing solely for educational purposes and not for purposes of profit and which is wholly or substantially financed by the Government.
- (iiic) any hospital or other institution for the reception and treatment of persons during convalescence or of persons suffering from illness or mental defectiveness or for the reception and treatment of persons requiring medical attention or rehabilitation, existing solely for philanthropic purposes and not for purposes of profit and which is wholly or substantially financed by the Government.

- (iiiad) any university or other educational institution existing solely for educational purposes and not for the purposes of profit, if the aggregate annual receipts of such university or educational institution do not exceed the amount of annual receipts as may be prescribed.
- (iiiae) any hospital or other institution for the reception and treatment of persons suffering from illness or mental defectiveness or for the reception and treatment of persons during convalescence or of persons requiring medical attention or rehabilitation, existing solely for philanthropic purposes and not for the purposes of profit, if the aggregate annual receipts of such hospital or institution do not exceed the amount of annual receipts as may be prescribed.
- (iv) any other fund or institution established for charitable purposes which may be notified by the Central Government in the Official Gazette, having regard to the objects of the fund or institution and its importance throughout India or throughout any State or States; or
- (v) any trust (including any other legal obligation) or institution wholly for public religious and charitable purposes, as notified by the Central Government having regard to the manner in which the affairs of the trust or institution are administered and supervised for ensuring that the income accruing thereto is properly applied for the objects thereof.
- (vi) any university or other educational institution existing solely for educational purposes and not for purposes of profit, other than those mentioned in (v) and (vii) supra and which may be approved by the prescribed authority.
- (via) any hospital or other institution for the reception and treatment of persons suffering from illness or mental defectiveness or for the reception and treatment of persons during convalescence or of persons requiring medical attention or rehabilitation existing solely for philanthropic purposes and not for purposes of profit other than those mentioned in (vi) and (viii) supra and which may be approved by the prescribed authority.

Further, where the total receipts of the bodies mentioned in (iv), (v), (vi) and (via) exceed one crore rupees in the previous year or any preceding year, such body shall:

- (a) publish its accounts in a local news paper; and
- (b) furnish alongwith exemption application, the copy of the local newspaper in which such accounts have been published.

For obtaining the exemption as well as continuance thereof, the fund or trust or institution or any university or other educational institution or any hospital or other medical institution has to make an application to the prescribed authority in the prescribed form. Further, the Central Government before notifying the fund or trust or institution may make such inquiries or may call for such documents (including audited annual accounts) for satisfying itself about the genuineness of the activities of the fund or trust or institution.

Finance Act, 1999 has amended Section 10(23C) to the effect that from assessment year 1999-2000, the prescribed authority will also have power to call for documents or information or to hold such enquiries as it deems fit before the university or other educational institution or a hospital or other medical institution is approved by it.

Provided also that the fund or trust or institution or any university or other educational institution or any hospital or other medical institution:

- (a) applies its income, or accumulates it for application, wholly and exclusively to the object for which it is established and in a case where more than fifteen per cent of its income is accumulated on or after the 1st day of April, 2002, the period of the accumulation of the amount exceeding fifteen per cent of its income shall in no case exceed five years; and

- (b) the fund or trust or institution applies its income or accumulates it for application wholly and exclusively to the objects for which it is established and invests or deposits its funds, other than -
- (i) any assets held by the fund, trust or institution where such assets form part of the corpus of the fund, trust or institution or any university or other educational institution or any hospital or other medical institution as on the 1st day of June, 1973;
 - (ia) any asset, being equity shares of a public company, held by any university or other educational institution or any hospital or other medical institution where such asset form part of the corpus of any university or other educational institution or any hospital or other medical institution as on the 1st day of June, 1998.
 - (ii) any assets (being debentures issued by, or on behalf of, any company or corporation), acquired by the fund, trust or institution or any university or other educational institution or any hospital or other medical institution before the 1st day of March, 1983;
 - (iii) any accretion to the shares, forming part of the corpus mentioned in sub-clause (i) and (ia), by way of bonus shares allotted to the fund, trust or institution or any university or other educational institution or any hospital or other medical institution;
 - (iv) voluntary contributions received and maintained in the form of jewellery, furniture or any other article as the Board may, by notification in the Official Gazette, specify,

for any period during the previous year in the forms and modes as specified in Section 11(5). In case of investments made before April 1, 1989 otherwise than in any one or more of the forms or modes as mentioned in Section 11(5), the same shall be exempt if such investments do not continue to remain so invested or deposited after the 30th day of March, 1993.

The exemption in relation to voluntary contribution [other than voluntary contribution in cash or voluntary contribution of the nature referred to in sub-clauses (i), (ii), (iii), (iv) above] shall be granted subject to the condition that such voluntary contribution is not held by the trust or institution otherwise than in any one or more of the forms or modes specified in Section 11(5) after the expiry of one year from the end of the previous year in which such asset is acquired or the 31st day of March, 1992, whichever is later; Exemption in relation to any income of the fund or trust or institution from profits and gains of the business shall not be allowed unless the business is incidental to the attainment of its objectives and separate books of account are maintained by it in respect of such business.

Any amount of donation received by the fund or institution in terms of Section 80G(2)(d) which has been utilised for purposes other than providing relief to the victims of earthquake in Gujarat or which remains unutilised in terms of Section 80G(5C) and not transferred to the Prime Minister's National Relief Fund on or before 31st day of March, 2004, shall be deemed to be the income of the previous year and shall accordingly be charged to tax.

Further, the tax exemption granted to the fund or trust or institution notified in this behalf shall at any one time have effect for such assessment year or years, not exceeding three assessment years, as may be specified in the notification, including an assessment year or years which commenced before the date of issue of the notification.

Where the fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) does not apply its income during the year of receipt and accumulates it, any payment or credit out of such accumulation to any trust or institution registered under Section 12AA or to any fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) shall not be treated as application of income to the objects for which such fund or trust or institution or university or educational institution or hospital or other medical institution, as the case may be, is established.

Further, the exemption under this clause shall be withdrawn if prescribed authority is satisfied that conditions are not being fulfilled after an opportunity of being heard is provided.

In case the fund or trust or institution or any university or other educational institution or any hospital or other medical institution referred to in the first proviso makes an application on or after the 1st day of June, 2006 for the purposes of grant of exemption or continuance thereof, such application shall be made on or before the 30th day of September of the relevant assessment year from which the exemption is sought.

It is also provided with retrospective effect from assessment year 2009-10, by the Finance Act, 2012, that the income of a trust or institution referred to in sub-clause (iv) or sub-clause (v) shall be included in its total income of the previous year if the provisions of the first proviso to clause (15) of section 2 become applicable to such trust or institution in the said previous year, whether or not any approval granted or notification issued in respect of such trust or institution has been withdrawn or rescinded;

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

Income of a Mutual Fund [Section 10(23D)]

Subject to the provisions of Chapter XIIE any income of a Mutual Fund set up by a public sector bank or a public financial institution or authorised by the Securities and Exchange Board of India or the Reserve Bank of India is exempt from tax. This exemption is subject to such conditions as the Central Government may, by notification in the Official Gazette, specify in this behalf. However, these conditions are not applicable in case of a Mutual Fund is registered under the SEBI.

Explanation: For the purpose of this clause:

- (a) the expression 'public sector bank' means the State Bank of India constituted under the State Bank of India Act, 1955, a subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959, a corresponding new Bank constituted under Section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 or under Section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 and a bank included in the category "other public sector banks" by the Reserve Bank of India;
- (b) the expression "public financial institution" shall have the meaning assigned to it in Section 4A of the Companies Act, 1956.

The financial institutions specified by Section 4A of the Companies Act, 1956, are as follows:

- (i) ICICI.
- (ii) IFCI.
- (iii) IDBI.
- (iv) LIC.
- (v) UTI.
- (vi) The Industrial Reconstruction Corporation of India established under the Industrial Reconstruction Bank of India Act, 1984 (62 of 1984).
- (vii) The General Insurance Corporation of India established under the General Insurance Business (Nationalisation) Act, 1972 (57 of 1972).
- (viii) The National Insurance Company Limited, formed and registered under the Companies Act, 1956 (1 of 1956).
- (ix) The New India Assurance Company Limited, formed and registered under the Companies Act, 1956 (1 of 1956).

- (x) The Oriental Insurance Company Limited, formed and registered under the Companies Act, 1956 (1 of 1956).
 - (xi) The United Insurance Company Limited, formed and registered under the Companies Act, 1956 (1 of 1956).
 - (xii) Risk Capital and Technology Finance Corporation Ltd.
 - (xiii) Technology Development and Information Company of India Ltd.
- (c) the expression 'Securities and Exchange Board of India' shall have the meaning assigned to it in clause (a) of Sub-section (1) of Section 2 of the Securities and Exchange Board of India Act, 1992.

ANY INCOME OF A SECURITISATION TRUST FROM THE ACTIVITY OF SECURITISATION (SECTION 23DA)

In order to facilitate the securitisation process, special taxation regime is provided in respect of taxation of income of securitisation entities, set up as a trust, from the activity of securitisation. Therefore, section 10 has been amended for providing a special tax regime. The salient features of the special regime are as follows:

- (i) In case of securitisation vehicles which are set up as a trust and the activities of which are regulated by either SEBI or RBI, the income from the activity of securitisation of such trusts will be exempt from taxation.
 - (ii) The securitisation trust will be liable to pay additional income-tax on income distributed to its investors on the line of distribution tax levied in the case of mutual funds. The additional income-tax shall be levied @ 25% in case of distribution being made to investors who are individual and HUF and @ 30% in other cases. No additional income tax shall be payable if the income distributed by the securitisation trust is received by a person who is exempt from tax under the Act.
 - (iii) Consequent to the levy of distribution tax, the distributed income received by the investor will be exempt from tax.
 - (iv) The securitisation trust will be liable to pay interest at the rate of one percent for every month or part of the month on the amount of additional income-tax not paid within the specified time.
 - (v) The person responsible for payment of income or the securitisation trust will be deemed to be an assessee in default in respect of amount of tax payable by him or it in case the additional income-tax is not paid to the credit of Central Government.
- (a) "Securitisation" shall have the same meaning as assigned to it,—
- (i) in clause (r) of sub-regulation (1) of regulation 2 of the Securities and Exchange Board of India (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008 made under the Securities and Exchange Board of India Act, 1992 (15 of 1992) and the Securities Contracts (Regulation) Act, 1956 (42 of 1956); or
 - (ii) under the guidelines on securitisation of standard assets issued by the Reserve Bank of India;

As per regulation 2(1)(r) of SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008, Securitisation means acquisition of debts or receivable by any special purpose distinct entity from any originator or originators for the purpose of issuance securitised debt instruments based on such debts or receivables and such issuance.

Securitisation Debt Instruments means any certificate or instrument issued to an investor by an issuer being a special purpose distinct entity which processes any debt or receivables including mortgage debt assigned to such entity and acknowledging beneficial interest of such investors in such debt or receivables including mortgage debt as the case may be.

(b) "Securitisation trust" shall have the meaning assigned to it in the Explanation below section 115TC;

Securitisation Trust means a trust, being a –

- (i) "special purpose distinct entity" as defined in regulation 2(1)(u) of the Securities and Exchange Board of India (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008 made under the Securities and Exchange Board of India Act, 1992 (15 of 1992) and the Securities Contracts (Regulation) Act, 1956 (42 of 1956), and regulated under the said regulations; or
- (ii) "Special Purpose Vehicle" as defined in, and regulated by, the guidelines on securitisation of standard assets issued by the Reserve Bank of India, which fulfils such conditions, as may be prescribed.

Income of Investor Protection Fund (Section 23EA)

Any income by way of contributions received from recognized stock exchanges and members thereof, of such Investor Protection Fund set up by recognised stock exchanges in India, either jointly or separately, as the Central Government may, by notification in the Official Gazette, specify in this behalf:

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

Income of Credit Guarantee Fund Trust for SSI [Section 10(23EB)]

Any income of the Credit Guarantee Fund Trust for Small Industries, being a trust created by the Government of India and the Small Industries Development Bank of India established under Sub-section (1) of Section 3 of the Small Industries Development Bank of India Act, 1989 (39 of 1989), for five previous years relevant to the assessment years beginning on the 1st day of April, 2002 and ending on the 31st day of March, 2007.

Income of Investor Protection fund set up Commodity Exchange of India [Section 10(23EC)]

Any income, by way of contributions received from commodity exchanges and the members thereof, of such Investor Protection Fund set up by commodity exchanges in India, either jointly or separately, as the Central Government may, notify shall be exempt.

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

Explanation: For the purposes of this clause, "commodity exchange" shall mean a "registered association" as defined in clause (jj) of section 2 of the Forward Contracts (Regulation) Act, 1952 (74 of 1952).

Income of Investor Protection fund set up in accordance depository regulations [Section 10(23ED)]

Any income, by way of contributions received from a depository, of such Investor Protection Fund set up in accordance with the regulations by a depository as the Central Government may notify shall be exempt.

However, where any amount standing to the credit of the Fund and not charged to income-tax during any previous year is shared, either wholly or in part with a depository, the whole of the amount so shared shall be deemed to be the income of the previous year in which such amount is so shared and shall, accordingly, be chargeable to income-tax.

Explanation: For the purposes of this clause, –

- (i) "depository" shall have the same meaning as assigned to it in clause (e) of sub-section (1) of section 2 of the Depositories Act, 1996 (22 of 1996);
- (ii) "regulations" means the regulations made under the Securities and Exchange Board of India Act, 1992 (15 of 1992) and the Depositories Act, 1996 (22 of 1996);

INCOME OF VENTURE CAPITAL COMPANY [10(23FB)]

Any Income of a Venture Capital Company or Venture Capital Fund from investment in the Venture Capital Undertaking shall be exempt.

(a) "Venture capital company" means a company which –

- (A) has been granted a certificate of registration, before the 21st day of May, 2012, as a Venture Capital Fund and is regulated under the Securities and Exchange Board of India (Venture Capital Funds) Regulations, 1996 (hereinafter referred to as the Venture Capital Funds Regulations) made under the Securities and Exchange Board of India Act, 1992 (15 of 1992); or
- (B) has been granted a certificate of registration as Venture Capital Fund as a sub-category of Category I Alternative Investment Fund and is regulated under the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012 (hereinafter referred to as the Alternative Investment Funds Regulations) made under the Securities and Exchange Board of India Act, 1992 (15 of 1992), and which fulfils the following conditions, namely:–
 - (i) it is not listed on a recognised stock exchange;
 - (ii) it has invested not less than two-thirds of its investible funds in unlisted equity shares or equity linked instruments of venture capital undertaking; and
 - (iii) it has not invested in any venture capital undertaking in which its director or a substantial shareholder (being a beneficial owner of equity shares exceeding ten per cent of its equity share capital) holds, either individually or collectively, equity shares in excess of fifteen per cent of the paid-up equity share capital of such venture capital undertaking;

(b) "Venture capital fund" means a fund –

- (A) Operating under a trust deed registered under the provisions of the Registration Act, 1908 (16 of 1908), which –
 - (I) has been granted a certificate of registration, before the 21st day of May, 2012, as a Venture Capital Fund and is regulated under the Venture Capital Funds Regulations; or
 - (II) has been granted a certificate of registration as Venture Capital Fund as a sub-category of Category I Alternative Investment Fund under the Alternative Investment Funds Regulations and which fulfils the following conditions, namely: –
 - (i) it has invested not less than two-thirds of its investible funds in unlisted equity shares or equity linked instruments of venture capital undertaking;
 - (ii) it has not invested in any venture capital undertaking in which its trustee or the settler holds, either individually or collectively, equity shares in excess of fifteen per cent of the paid-up equity share capital of such venture capital undertaking; and
 - (iii) the units, if any, issued by it are not listed in any recognised stock exchange; or
- (B) operating as a venture capital scheme made by the Unit Trust of India established under the Unit Trust of India Act, 1963 (52 of 1963);

(c) "venture capital undertaking" means –

- (i) a venture capital undertaking as defined in clause (n) of regulation 2 of the Venture Capital Funds Regulations; or
- (ii) a venture capital undertaking as defined in clause (aa) of sub-regulation (1) of regulation 2 of the Alternative Investment Funds Regulations

As per Regulation 2(n) of Venture Capital Funds Regulations "Venture capital undertaking" means—

- (1) whose shares are not listed on a recognised stock exchange in India
- (2) which is engaged in the business for providing services, production, or manufacture of article or things or does not include such activities or sectors which are specified in the negative list by the Board with the approval of central government by notification in the official gazette in this behalf or

As per Regulation 2(1)(aa) of the Alternative Investment Funds Regulations, Venture capital undertaking means domestic company

- (1) which is not listed on recognised stock exchange in India at the time of making investment and
- (2) which is engaged in the business for providing services, production or manufacture of article or things and does not include following activities or sectors
 - Non Banking Financial Company (NBFC)
 - Gold Financing
 - Activities not permitted under industrial policy of Government of India.
 - Any other activity which may be specified by the Board in consultation with Government of India.

Income of a Registered Trade Union [Section 10(24)]

Any income chargeable under the head 'income from house property' and income from other sources of a registered Trade Union within the meaning of the Indian Trade Unions Act, 1926, formed primarily for the purposes of regulating the relations between workmen and the employers or between the workmen and the workmen is exempt from income-tax and also of a federation of such unions.

Income to Trustees of certain Funds [Section 10(25)]

The following incomes are exempt from tax under this provision:

- (i) Interest on securities which are held by or which are the property of any statutory provident fund to which the Provident Funds Act, 1925 applies and any capital gains of the fund arising from the sale, exchange or transfer of such securities.
- (ii) Any income received by the trustees on behalf of a recognised provident fund, an approved superannuation fund or an approved gratuity fund.
- (iii) Any income received by the Board of Trustees constituted under the Coal Mines Provident Fund and Miscellaneous Provisions Act, 1948, on behalf of the Deposit-linked Insurance Fund.
- (iv) Any income received by the Board of Trustees constituted under the Employees' Provident Fund and Miscellaneous Provisions Act, 1952 on behalf of the Deposit-linked Insurance Fund.

Exemption to Employee's State Insurance Fund [Section 10(25A)]

A new clause (25A) has been inserted in Section 10 of the Act, with effect from the assessment year 1962-63 onwards to provide income-tax exemption on any income of the Employees' State Insurance Fund of the Employees' State Insurance Corporation set up under the provisions of the Employees' State Insurance Act, 1948.

Income of a Member of a Scheduled Tribe [Section 10(26)]

Members of a Scheduled Tribe as defined in Article 366(25) of the Constitution residing in certain areas specified in paragraph 20 of the Sixth Schedule to the Constitution or in the States of Arunachal Pradesh, Mizoram, Nagaland, Manipur and Tripura or in the Ladakh region of the State of Jammu and Kashmir are exempt from tax

on any income which accrues or arises to them from any source in the area, State or Union Territories mentioned above or by way of dividend or interest on securities arising from any place in or outside India.

Income of a Resident of Ladakh [Section 10(26A)]

Any income accruing or arising to any person from any source in the district of Ladakh or outside India in any previous year relevant to the assessment year commencing before 1.4.1989 will be exempt from tax, where such person is resident in the district of Ladakh in that previous year. However, this exemption would not apply in the case of any such person unless he was resident in that district in the previous year relevant to the assessment year 1962-63 or earlier. For the purposes of this section the district of Ladakh will include all the areas comprised in that district on June 30, 1979, that is, the date after which the said district was bifurcated.

Income of a Corporation Established for Promoting Interest of Scheduled Castes etc. [Section 10(26B)]

Any income of a corporation established by a Central, State or Provincial Act or any other body, institution or association wholly financed by government where it has been formed for promoting the interest of the members of the Scheduled Castes or the Scheduled Tribes or the backward classes or any two or all of them is exempt from tax.

Exemption to National Minorities Development and Finance Corporation [Section 10(26BB)]

With effect from the assessment year 1995-96 a new clause (26BB) has been inserted in Section 10 to provide income-tax exemption on any income of a corporation established by the Central Government or any State Government for promoting the interests of the members of such minority communities as are notified by the Central Government from time to time.

Exemption from Income of a Corporation established for the Welfare and Economic Upliftment of Ex-servicemen being Citizens of India [Section 10(26BBB)]

Finance Act, 2003 has inserted a new clause (26BB) in Section 10 to provide income-tax exemption on any income of a corporation established by a Central, State or Provincial Act for the welfare and economic upliftment of ex-servicemen being the citizens of India. [Section 10(26BBB)].

Explanation. – For the purposes of this clause, “ex-serviceman” means a person who has served in any rank, whether as combatant or non-combatant, in the armed forces of the Union or armed forces of the Indian States before the commencement of the Constitution (but excluding the Assam Rifles, Defence Security Corps, General Reserve Engineering Force, Lok Sahayak Sena, Jammu and Kashmir Militia and Territorial Army) for a continuous period of not less than six months after attestation and has been released, otherwise than by way of dismissal or discharge on account of misconduct or inefficiency, and in the case of a deceased, or incapacitated ex-serviceman includes his wife, children, father, mother, minor brother, widowed daughter and widowed sister, wholly dependant upon such ex-serviceman immediately before his death or incapacitation.

Income of Co-operative Societies Promoting the Interest of Members of Scheduled Castes, etc. [Section 10(27)]

Any income of a cooperative society formed for promoting the interests of the members of either the scheduled castes or scheduled tribes or both referred to in clause (26B) will be exempt from tax. In order to avail exemption the membership of the co-operative society should consist of only other co-operative societies formed for similar purposes and the finances of the society are provided by the government and such other societies.

Exemption of Commodity Boards and Authorities from Income-tax [Section 10(29A)]

A new clause (29A) has been inserted in Section 10. It provides that the income of certain commodity Boards and Export development authorities which are set up under various statutes and are under the administrative control of the Commerce Ministry will be exempt from income-tax. The specified boards and authorities are Coffee Board, the Rubber Board, the Tea Board, the Tobacco Board, the Marine Products Export development authority, the Agricultural and Processed Food Products Export Development Authority, the Spices Board and the coir Board established under section 4 of the Coir Industry Act (w.r.e.f 1st April, 2002). These Boards and authorities are exempt from the assessment year 1962-63 or the previous year in which these Boards or authorities were constituted, whichever is later.

Subsidy from the Tea Board [Section 10(30)]

In the case of an assessee engaged in the business of growing and manufacturing tea in India, the amount of Subsidy received from or through the Tea Board under any Notified Scheme of the Central Government for replantation or replacement of tea bushes or for rejuvenation or consolidation of areas used for cultivation of tea is exempt from income-tax.

For this purpose, the Central Government has notified the following schemes -

- (1) Replantation Subsidy Scheme of the Tea Board from October 1, 1968 (effective date 1.4.1969);
- (2) Amended Replantation Subsidy Scheme of the Tea Board as effective from May 12, 1970; and
- (3) Amended Replantation Subsidy Scheme of the Tea Board as effective from January 1, 1972.

To qualify for the exemption, the assessee has to submit, along with his return of income or within such further time as may be allowed by the Assessing Officer, a certificate from the Tea Board as to the amount of subsidy received by him during the relevant previous year.

Subsidy from the Rubber; Coffee; Spices and other Board or authority established under any law and notified by the Central Government [Section 10(31)]

In the case of an assessee carrying on business of growing and manufacturing rubber, coffee, cardamom or such other commodity in India, as notified by the Central Government, any subsidy received from or through the concerned Board(s) (as specified in the heading) under any scheme for replantation or replacement of rubber, coffee, cardamom or other specified commodity or for rejuvenation or consolidation of areas used for cultivation of rubber, coffee, cardamom or other specified commodity will be exempt from tax if the assessee furnishes to the Assessing Officer, along with his return of income a certificate from the concerned Board, as to the amount of such subsidy paid to the assessee, either along with his return of income or within such further time as may be allowed by the Assessing Officer.

Income of minor child [Section 10(32)]

Where the income of an individual includes any income of his minor child in terms of Section 64(1A), such individual shall be entitled to exemption of the amount includible under Section 64(1A) of each minor child or ₹ 1,500 for each minor child whichever is less.

Income from transfer of units of UTI [Section 10(33)]

Any income arising from the transfer of a capital asset, being a unit of the Unit Scheme, 1964 referred to in Schedule I to the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002 (58 of 2002) and where the transfer of such asset takes place on or after the 1st day of April, 2002 shall be exempt from income tax.

Any income by way of dividends referred to in Section 115-O [Section 10(34)]

Any income by way of dividends referred to in Section 115-O shall be exempt from income tax. As per section 115-O the company paying or declaring any dividend have to pay tax @15% plus surcharge 5% or 10% as the case may be plus education cess @3% on such dividend. Hence, such dividend shall be exempt in the hands of shareholders.

Any distributed income by way of Buy back of shares referred in section 115QA [Section 10(34A)]

Any income arising on account of buy back of shares (not being listed on a recognised stock exchange) by the company as referred to in section 115QA shall be exempt in the hands shareholders.

As per section 115QA, the company shall be liable to pay tax @20% plus surcharge plus education cess and SHEC on such distributed income on account of buy back of shares. Distributed income means the consideration paid by the company on buy-back of shares as reduced by the amount which was received by the company for issue of such shares.

Income from Mutual Funds and certain units [Section 10(35)]

Any income by way of, –

- (a) income received in respect of the units of a Mutual Fund specified under Clause (23D); or
- (b) income received in respect of units from the Administrator of the specified undertaking; or
- (c) income received in respect of units from the specified company

shall be exempt from income tax.

Provided that this clause shall not apply to any income arising from transfer of units of the Administrator of the specified undertaking or of the specified company or of a mutual fund, as the case may be.

Explanation. – For the purposes of this clause, –

- (a) “Administrator” means the Administrator as referred to in clause (a) of Section 2 of the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002 (58 of 2002);
- (b) “specified company” means a company as referred to in clause (h) of Section 2 of the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002 (58 of 2002);

Any income received by the investor distributed by Securitisation Trust under Section 115TA [Section 10(35A)]

Any income by way of distributed income referred to in section 115TA received from a securitisation trust by any person being an investor of the said trust shall be exempt.

Explanation : For the purposes of this clause, the expressions “investor” and “securitisation trust” shall have the meanings respectively assigned to them in the *Explanation* given in section 115TC.

Transfer of Specified Equity Shares [Section 10(36)]

Any income arising from the transfer of a long-term capital asset, being an eligible equity share in a company purchased on or after the 1st day of March, 2003 and before the 1st day of March, 2004 and held for a period of twelve months or more shall be exempt from income tax.

Explanation. – For the purposes of this clause, “eligible equity share” means, –

- (i) any equity share in a company being a constituent of BSE-500 Index of the Stock Exchange, Mumbai as

on the 1st day of March, 2003 and the transactions of purchase and sale of such equity share are entered into on a recognised stock exchange in India;

- (ii) any equity share in a company allotted through a public issue on or after the 1st day of March, 2003 and listed in a recognised stock exchange in India before the 1st day of March, 2004 and the transaction of sale of such share is entered into on a recognised stock exchange in India.

Income from Transfer of Agricultural Land [Section 10(37)]

In the case of an assessee, being an individual or a Hindu undivided family, any income chargeable under the head "Capital gains" arising from the transfer of agricultural land, where –

- (i) such land is situate in any area referred to in item (a) or item (b) of sub-clause (iii) of clause (14) of Section 2;
- (ii) such land, during the period of two years immediately preceding the date of transfer, was being used for agricultural purposes by such Hindu undivided family or individual or a parents;
- (iii) such transfer is by way of compulsory acquisition under any law, or a transfer the consideration for which is determined or approved by the Central Government or the Reserve Bank of India;
- (iv) such income has arisen from the compensation or consideration for such transfer received by such assessee on or after 1st day of April, 2004.

shall be exempt from income tax.

Explanation: For the purposes of this clause, the expression "compensation or consideration" includes the compensation or consideration enhanced or further enhances by any court, tribunal or other authority.

Income from Transfer of certain equity, units etc. [Section 10(38)]

Any income arising on or after 1.10.2004 from the transfer of long-term capital asset, being an equity share in a company or a unit of an equity oriented fund where –

- (a) the transaction of sale of such equity share or unit is entered into on or after the date on which Chapter VII of the Finance (No. 2) Act, 2004 comes into force; and
- (b) such transaction is chargeable to securities transaction tax under that chapter.

shall be exempt from income tax.

Provided that the income by way of long-term capital gain of a company shall be taken into account in computing the book profit and the income tax payable under Section 115JB.

Explanation: For the purpose of this clause, "equity oriented fund" means a fund –

- (i) where the investible funds are invested by way of equity shares in domestic companies to the extent of more than sixty-five percent of the total proceeds of such fund; and
- (ii) which has been set up under a scheme of Mutual Fund specified under clause 10(23D).

Provided that the percentage of equity share holding of the fund shall be computed with reference to the annual average of the monthly average of the opening and closing figures.

Income from international sporting events [Section 10(39)]

Any specified income, arising from any international sporting event held in India, to the person or persons notified by the Central Government in the Official Gazette, if such international sporting event –

- (a) is approved by the international body regulating the international sport relating to such event;
- (b) has participation by more than two countries;
- (c) is notified by the Central Government in the Official Gazette for the purposes of this clause.

shall be exempt from income tax.

Explanation: For the purposes of this clause, “the specified income” means the income, of the nature and to the extent, arising from the international sporting event, which the Central Government may notify in this behalf;

Income from subsidiary company [Section 10(40)]

Any income of any subsidiary company by way of grant or otherwise received from an Indian company, being its holding company engaged in the business of generation or transmission or distribution of power if receipt of such income is for settlement of dues in connection with reconstruction or revival of an existing business of power generation shall be exempt from income tax.

Provided that the provisions of this clause shall apply if reconstruction or revival of any existing business of power generation is by way of transfer of such business to the Indian company notified under sub-clause (a) of clause (v) of Sub-section (4) of Section 80-IA.

Income from transfer of a capital asset [Section 10(41)]

Any income arising from transfer of a capital asset, being an asset of an undertaking engaged in the business of generation or transmission or distribution of power where such transfer is effected on or before the 31st day of March, 2006, to the Indian company notified under sub-clause (a) of clause (v) of Sub-section (4) of Section 80-IA shall be exempt from income tax.

Specified income to a body or authority [Section 10(42)]

Any specified income arising to a body or authority which –

- (a) has been established or constituted or appointed under a treaty or an agreement entered into by the Central Government with two or more countries or a convention signed by the Central Government;
- (b) is established or constituted or appointed not for the purposes of profit;
- (c) is notified by the Central Government in the Official Gazette for the purposes of this clause.

Explanation: For the purposes of this clause, “specified income” means the income, of the nature and to the extent, arising to the body or authority referred to in this clause, which the Central Government may notify in this behalf.

Income to an Individual by way Reverse Mortgage [Section 10(43)]

Any amount received by an individual as a loan, either in lumpsum or in instalment, in a transaction of reverse mortgage referred to in clause (xvi) of Section 47.

Meaning of Reverse Mortgage

Under reverse mortgage a person (generally senior citizen) who owns a house property have the option to mortgage the property with a schedule bank or housing finance company to get a regular income in the form of periodical instalments. This scheme is very attractive for senior citizens who do not have regular income. In this scheme, the lender (the bank or housing finance company) will recover the amount paid i.e principle and interest thereon by selling the property after the death of borrower. However the lender will have to give the option to the legal heirs of the borrower to repay the loan amount along with interest for the release of property.

New Pension System Trust [Section 10(44)]

Any income received by any person for, or on behalf of, the New Pension System Trust established on the 27th February, 2009 under the provisions of the Indian Trust Act, 1882 shall be exempt from Incom tax.

Allowance or Perquisite to the chairman of UPSC [Section 10(45)]

Allowances or perquisites which are notified by the Central Government in the Official Gazette shall be exempt in the hands of the Chairman or a retired Chairman or any other member or retired member of the Union Public Service Commission.

Income arising to a Body, Authority or Board or Trust or Commission [Section 10(46)]

Any specified income notified by the Central Government arising to a body or authority or Board or Trust or Commission (by whatever name called) which:

- (a) has been established or constituted by or under a Central, State or Provincial Act, or constituted by the Central Government or a State Government, with the object of regulating or administering any activity for the benefit of the general public;
- (b) is not engaged in any commercial activity; and
- (c) is notified by the Central Government in the Official Gazette

shall be exempt.

Income of an Infrastrucutre Debt Fund [Section 10(47)]

Any income of an infrastructure debt fund, set up in accordance with the guidelines as may be prescribed, which is notified by the Central Government in the Official Gazette shall be exempt.

Income received by certain foreign companies in India in Indian currency from sale of crude oil to any person in India [Section 10(48)]

Any income received in India in Indian currency by a foreign company on account of sale of crude oil, any other goods or rendering of services, as may be notified by Central Government this behalf, to any person shall be exempt in the hands of Foreign Company.

However, to claim this exemption the following conditions may be satisfied:

- (i) receipt of such income in India by the foreign company is pursuant to an agreement or an arrangement entered into by the Central Government or approved by the Central Government;
- (ii) having regard to the national interest, the foreign company and the agreement or arrangement are notified by the Central Government in this behalf; and
- (iii) the foreign company is not engaged in any activity, other than receipt of such income, in India.]

Income of National Financial Holdings Company Limited [Section 10(49)]

Any income of the National Financial Holdings Company Limited, being a company set up by the Central Government, of any previous year relevant to any assessment year commencing on or before the 1st day of April, 2014 shall be exempt.

SPECIFIC EXEMPTION

We have discussed general exemption generally available to all assessee depending upon the purpose for which it is made. Now let us discuss section 10AA, etc., relating to specific exemption available to industrial undertakings on fulfillment of specified conditions.

Special provisions in respect of newly established Units in Special Economic Zone (Section 10AA)

(1) Subject to the provisions of this section, in computing the (j) of section 2 of the Special Economic Zones Act, 2005, from his Unit, who begins to manufacture or produce articles or things or provide any service during the previous year relevant to any assessment year commencing on or after the 1st day of April, 2006, a deduction of –

- (i) hundred per cent of profits and gains derived from the export, of such articles or things or from services for a period of five consecutive assessment years beginning with the assessment year relevant to the previous year in which the Unit begins to manufacture or produce such articles or things or provide services, as the case may be, and fifty per cent of such profits and gains for further five assessment years and thereafter;
- (ii) for the next five consecutive assessment years, so much of the amount not exceeding fifty per cent of the profit as is debited to the profit and loss account of the previous year in respect of which the deduction is to be allowed and credited to a reserve account (to be called the "Special Economic Zone Re-investment Reserve Account") to be created and utilized for the purposes of the business of the assessee in the manner laid down in sub-section (2).

(2) The deduction under clause (ii) of sub-section (1) shall be allowed only if the following conditions are fulfilled, namely:

- (a) the amount credited to the Special Economic Zone Re-investment Reserve Account is to be utilised –
 - (i) for the purpose of acquiring machinery or plant which is first put to use before the expiry of a period of three years following the previous year in which the reserve was created; and
 - (ii) until the acquisition of the machinery or plant as aforesaid, for the purposes of the business of the undertaking 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;
- (b) the particulars, as may be specified by the Central Board of Direct Taxes in this behalf, under clause (b) of sub-section (1B) of section 10A have been furnished by the assessee in respect of machinery or plant along with the return of income for the assessment year relevant to the previous year in which such plant or machinery was first put to use.

(3) Where any amount credited to the Special Economic Zone Re-investment Reserve Account under clause (ii) of sub-section (1), –

- (a) has been utilised for any purpose other than those referred to in sub-section (2), the amount so utilised; or
- (b) has not been utilised before the expiry of the period specified in sub-clause (i) of clause (a) of sub-section (2), the amount not so utilised,

shall be deemed to be the profits, –

- (i) in a case referred to in clause (a), in the year in which the amount was so utilised; or
- (ii) in a case referred to in clause (b), in the year immediately following the period of three years specified in sub-clause (i) of clause (a) of sub-section (2),

and shall be charged to tax accordingly:

Provided that where in computing the total income of the Unit for any assessment year, its profits and gains had not been included by application of the provisions of sub-section (7B) of section 10A, the undertaking, being the Unit shall be entitled to deduction referred to in this sub-section only for the unexpired period of ten consecutive assessment years and thereafter it shall be eligible for deduction from income as provided in clause (ii) of sub-section (1).

Explanation: For the removal of doubts, it is hereby declared that an undertaking, being the Unit, which had already availed, before the commencement of the Special Economic Zones Act, 2005, the deductions referred to in section 10A for ten consecutive assessment years, such Unit shall not be eligible for deduction from income under this section:

Provided further that where a Unit initially located in any free trade zone or export processing zone is subsequently located in a Special Economic Zone by reason of conversion of such free trade zone or export processing zone into a Special Economic Zone, the period of ten consecutive assessment years referred to above shall be reckoned from the assessment year relevant to the previous year in which the Unit began to manufacture, or produce or process such articles or things or services in such free trade zone or export processing zone:

Provided also that where a Unit initially located in any free trade zone or export processing zone is subsequently located in a Special Economic Zone by reason of conversion of such free trade zone or export processing zone into a Special Economic Zone and has completed the period of ten consecutive assessment years referred to above, it shall not be eligible for deduction from income as provided in clause (ii) of sub-section (1) with effect from the 1st day of April, 2006.

(4) This section applies to any undertaking, being the Unit, which fulfils all the following conditions, namely:

- (i) it has begun or begins to manufacture or produce articles or things or provide services during the previous year relevant to the assessment year commencing on or after the 1st day of April, 2006 in any Special Economic Zone;
- (ii) it is not formed by the splitting up, or the reconstruction, of a business already in existence:

Provided that this condition shall not apply in respect of any undertaking, being the Unit, which is formed as a result of the re-establishment, reconstruction or revival by the assessment of the business of any such undertaking as is referred to in section 33B, in the circumstances and within the period specified in that section;

- (iii) it is not formed by the transfer to a new business, of machinery plant previously used for any purpose.

Explanation: The provisions of Explanations 1 and 2 to sub-section (3) of section 80-IA shall apply for the purposes of clause (iii) of this sub-section as they apply for the purposes of clause (ii) of that sub-section.

(5) Where any undertaking being the Unit which is entitled to the deduction under this section is transferred, before the expiry of the period specified in this section, to another undertaking, being the Unit in a scheme of amalgamation or demerger, –

- (a) no deduction shall be admissible under this section to the amalgamating or the demerged Unit, being the company for the previous year in which the amalgamation or the demerger takes place; and
- (b) the provisions of this section shall, as they would have applied to the amalgamating or the demerged Unit being the company as if the amalgamation or demerger had not taken place.

(6) Loss referred to in sub-section (1) of section 72 or sub-section (1) or sub-section (3) of section 74, in so far as such loss relates to the business of the undertaking, being the Unit shall be allowed to be carried forward or set off.

(7) For the purposes of sub-section (1), the profits derived from the export of articles or things or services

(including computer software) shall be the amount which bears to the profits of the business of the undertaking, being the Unit, the same proportion as the export turnover in respect of such articles or things or services bears to the total turnover of the business carried on by the undertaking (Substituted for the word 'Assessee' by Finance Act, 2009).

Provided that the provisions of this section shall retrospectively applicable from assessment year beginning on 1st day of April 2006 and subsequent assessment year.

(8) The provisions of sub-sections (5) and (6) of section 10A shall apply to the articles or things or services referred to in sub-section (1) as if –

- (a) for the figures, letters and word "1st April, 2001", the figures, letters and word "1st April, 2006" had been substituted;
- (b) for the word "undertaking", the words "undertaking, being the Unit" had been substituted.

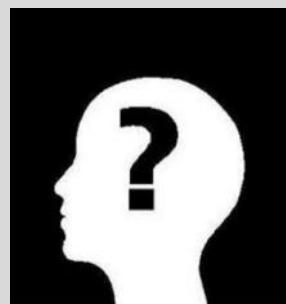
(9) The provisions of sub-section (8) and sub-section (1) of section 80-IA shall, so far as may be, apply in relation to the undertaking referred to in this section as they apply for the purposes of the undertaking referred to in section 80-IA.

Explanation 1. – For the purposes of this section, –

- (i) "export turnover" means the consideration in respect of export by the undertaking, being the Unit of articles or things or services received in, or brought into, India by the assessee but does not include freight, telecommunication charges or insurance attributable to the delivery of the articles or things outside India or expenses, if any, incurred in foreign exchange in rendering of services (including computer software) outside India;
- (ii) "export in relation to the Special Economic Zones" means taking goods or providing services out of India from a Special Economic Zone by land, sea, air, or by any other mode, whether physical or otherwise;
- (iii) "manufacture" shall have the same meaning as assigned to it in clause (r) of section 2 of the Special Economic Zones Act, 2005;
- (iv) "relevant assessment year" means any assessment year falling within a period of fifteen consecutive assessment years referred to in this section;
- (v) "Special Economic Zone" and "Unit" shall have the same meanings as assigned to them under clauses (za) and (zc) of section 2 of the Special Economic Zones Act, 2005.

Explanation 2. – For the removal of doubts, it is hereby declare that the profits and gains derived from on site development of computer software (including services for development of software) outside India shall be deemed to be the profits and gains derived from the export of computer software outside India.

Test Your Knowledge



- 1. Export turnover includes freight and telecommunication charges.**

- True
- False

TAX EXEMPTIONS FOR CHARITABLE TRUSTS AND INSTITUTIONS

Before the discussion of the provisions of the Income-tax Act in this connection, it is important to note the

meanings of the terms - Trust, Institution, Income from property, Charitable purpose and Religious purpose.

- (a) **Trust:** Section 3 of the Indian Trusts Act defines a trust to mean "an obligation annexed to the ownership of property and arising out of a confidence reposed in and accepted by the owner, or declared and accepted by him for the benefit of another and the owner".
- (b) **Institution:** An organisation with a constitution composed of a President, Vice-President, Secretary, Committee Members and ordinary members, is known as an Institution. The activities of the institution and its office-holders are regulated by rules and bye-laws of the institution. A university or a Chamber of Commerce is an Institution.
- (c) **Income from property:** This includes income from movable or immovable property, voluntary donations received and income from business undertaking(s) held by the trust.
- (d) **Charitable purpose:** The term 'charitable purpose' has been defined in this Act in a wider sense than what is commonly understood. According to Section 2(15) of the Act, it includes relief of the poor, education, medical relief, preservation of environment (including watersheds, forests and wildlife) and preservation of monuments or places or objects of artistic or historic interest and advancement of any other object of general public utility not involving the carrying on of any activity for profit.

In order to qualify for tax exemptions the charity must be of a public character, and the trust or institution should not be created or established for the benefit of any particular religious community or caste, if the trust or institution is established for the benefit of the member of a club or employees of a factory, it would not be a public charitable trust. Vide Circular No. 395 dated Sept. 24, 1984 promotion of sports and games is considered to be a charitable purpose within the meaning of Section 2(15). Accordingly an association or institution, engaged in the promotion of sports or games can claim exemption under Section 11, even if it is not approved under Section 10(23).

If advancement of any other object of general public utility involves any activity in the nature of trade, commerce or business or any activity of rendering any service in relation to any trade, commerce for any fee shall not be considered as charitable purpose however this restriction shall be applicable only if total receipts from these activities exceeds ₹25 lakh in a previous year.

Income not to be included in the Total Income

According to Section 11(1), the following items of income are not to be included in the total income of the previous year of the assessee who is in receipt of the same:

- (i) **Income derived from property held under trust wholly for charitable or religious purposes:** Income derived from property held under trust wholly for charitable or religious purposes shall be exempt to the extent to which such income is applied for such purposes in India and where any such income is accumulated or set apart for application to such purposes in India, to the extent to which the income so accumulated or set apart is not in excess of 15% of the income from such property.
- (ii) **Income derived from property held under trust in part only for charitable or religious purposes:** Income derived from property held under trust in part only for charitable or religious purposes shall be exempt. This exemption would, however, be available only for trusts created before 1.4.1962. Further, where any such income is finally set apart for application to such purposes in India, shall be exempt to the extent to which the income so set apart is not in excess of 15% of the income from such property.
- (iii) **Income from property held under trust created on or after 1.4.1952** for a charitable purpose which tends to promote international welfare in which India is interested shall be exempt to the extent to which such income is applied for such charitable purposes outside India.
- (iv) **Income from property held under trust created before 1.4.1952** for charitable or religious purposes

shall be exempt to the extent to which such income is applied for such purposes outside India. This exemption is, however, subject to the condition that the Central Board of Direct Taxes has, by a general or special order, issued a direction in either of the above two cases that the income in question would not be included in the total income of the person in receipt of such income.

- (v) **Income in the form of voluntary contributions** made with a specific direction that they shall form part of the corpus of the trust or institution shall be fully exempt.

Explanation:

In respect of items (i) and (ii) above:

- (1) In computing the 15% of the income which may be accumulated or set apart, any such voluntary contributions as are referred to in Section 12 (dealt with later in this Chapter) shall be deemed to be part of the income.
- (2) If, in the previous year, the income applied to charitable or religious purposes in India falls short of 85% of the income derived during that year from property held under trust, by any amount on account of (i) not receiving the income during that year, or (ii) for any other reason, then:
 - (a) In case referred to in (i), so much of the income applied to such purpose in India during the previous year in which the income is received or during the previous year immediately following as does not exceed the said amount shall be deemed to be income applied to such purposes during the previous year in which the income was derived; and the income so deemed to have been applied shall not be taken into account in calculating the amount of income applied to such purposes during the previous year in which the income is received or during the previous year immediately following, as the case may be.
 - (b) In case referred to in (ii), so much of the income applied to such purposes in India during the previous year immediately following the previous year in which the income was derived as does not exceed the said amount shall be deemed to be income applied to such purposes during the previous year in which the income was derived; and the income so deemed to have been applied shall not be taken into account in calculating the amount of income applied to such purposes during the previous year immediately following the previous year in which the income was derived.

Where any income as discussed in (a) and (b) above is not applied to charitable or religious purposes in India within the prescribed time, then such income shall be deemed to be the income of the person in receipt thereof:

- (a) In case of not receiving the income: Such income shall be deemed to be the income of the previous year immediately following the previous year in which the income was received.
- (b) In any other case: Such income shall be deemed to be the income of the previous year immediately following the previous year in which the income was derived [Clause (1B)].

Capital Gains [Section 11(1A)]

Asset held wholly for religious purposes or charitable purposes

Sometimes a capital asset held under trust wholly for charitable or religious purposes is transferred resulting in a capital gain. The net consideration received on such transfer may be utilised wholly or in part in acquiring another capital asset to be so held wholly for religious or charitable purposes. In such cases the capital gains arising from the transfer shall be deemed to have been applied for charitable or religious purposes to the extent stated hereinbelow:

- (i) Where the whole of the net consideration is utilised for acquiring the new capital assets, so much of the capital gains.
- (ii) Where only a part of the net consideration is utilised for acquiring the new capital asset, so much of the

capital gain as is equal to the amount by which the amount so utilised exceeds the cost of the transferred asset.

Example 1: A charitable trust had a capital asset the cost of which was ₹80,000 and it sold the same for ₹1,00,000. The whole of the consideration, i.e., ₹1,00,000 will be exempt from capital gains tax if a new capital asset is bought for ₹1,00,000.

Example 2: If a trust had a capital asset costing ₹ 1,00,000 and sold the same for ₹ 1,50,000 and then bought a capital asset for ₹ 1,30,000, then the working will be as follows:

	₹
Sale proceeds of old asset	1,50,000
Cost of the old asset	<u>1,00,000</u>
Capital gain	<u>50,000</u>
Cost of the new asset	1,30,000
Cost of the old asset	1,00,000
Capital gain utilised is	30,000
Capital gain taxable is	20,000

Assets held partly for religious or charitable purposes

It is quite possible that a capital asset is held by a trust partly for religious or charitable purposes. Where such a capital asset is transferred and the whole or any part of the net consideration is utilised for acquiring another capital asset, the appropriate fraction of the capital gain arising from the transfer shall be deemed to have been applied to charitable or religious purposes to the extent specified here under:

- (i) where the whole of the net consideration is utilised in acquiring the new capital asset, the whole of the appropriate fraction of such capital gain;
- (ii) in any other case, so much of the appropriate fraction of the capital gain as is equal to the amount, if any, by which the appropriate fraction of the amount utilised for acquiring the new asset exceeds the appropriate fraction of the cost of the transferred asset.

“Explanation” to Section 11(1A) provides:

‘Appropriate fraction’ means the fraction which represents the extent to which the income derived from the capital asset transferred was immediately before such transfer applicable to charitable or religious purposes.

‘Cost of the transferred asset’ means the aggregate of the cost of acquisition (as ascertained for the purposes of Section 48 and 49 of the capital asset which is the subject of the transfer and the cost of any improvement thereto within the meaning assigned to that expression in sub-clause (b) of clause (1) of Section 55.

‘Net consideration’ means the full value of the consideration received or accruing as a result of the transfer of the capital asset as reduced by any expenditure incurred wholly and exclusively in connection with such transfer.

Illustration

A trust has a capital asset costing ₹ 2,00,000 and 1/2 of its income is utilised for charitable purpose. It is sold for ₹ 3,50,000. If the trust buys another capital asset for ₹ 3,50,000 then appropriate fraction of the capital gain (₹ 3,50,000 - ₹ 2,00,000 = ₹ 1,50,000) i.e. ₹75,000 (1/2 of ₹ 1,50,000) will be deemed to have been applied for charitable purpose. Supposing that the trust buys another asset for ₹ 2,90,000, then the workings would be as shown hereunder:

₹	
Capital gain on transfer of capital asset	1,50,000
Appropriate fraction i.e. 1/2	75,000
Appropriate fraction utilised (1/2 of ₹ 2,90,000)	1,45,000
Appropriate fraction of the original capital asset	
1/2 of ₹ 2,00,000	1,00,000
Capital gain utilised	45,000
Capital gain not utilised	30,000

Accumulations of Income [Section 11(2)]

While dealing with Section 11 it has been stated that accumulation of income from trust property held for charitable purpose is permissible up to 15 per cent without attracting any liability to tax. Where the balance 85 per cent of the income is not applied or is not deemed to have been applied to charitable or religious purposes in India during the previous year, such income so accumulated or set apart shall not be included in the total income if the following conditions are fulfilled:

- (i) the assessee gives a notice to the Assessing Officer, in the prescribed manner, specifying the purpose for which the income is being accumulated or set apart and the period for which income is to be accumulated or set apart which shall in no case exceed 10 years.
- (ii) the money so accumulated or set apart is invested or deposited in the forms or modes specified in Sub-section (5).

However, in respect of any income accumulated or set apart on or after the 1st day of April, 2001 the provisions of this sub-section shall have effect as if for the words "ten years" at both the places where they occur, the words "five years" has been substituted.

Explanation: Any amount credited or paid, out of income referred to in clause (a) or clause (b) of Sub-section (1), read with the explanation to that sub-section, which is not applied, but is accumulated or set apart, to any trust or institution registered under Section 12AA or to any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) of clause (23C) of Section 10, shall not be treated as application of income for charitable or religious purposes, either during the period of accumulation or thereafter.

It is important to note that to claim exemption subject to Section 11(2) it is enough to invest in Government securities etc., only that part of the unspent balance which falls over and above 15% of the total income derived from the property held under trust [C.I.T. v. H.H. Marthanda Varma Elayaraja of Travancore Trust and others (1981) 129 I.T.R. 191 (Ker.)].

Section 11(3) provides that:

- (i) if the income accumulated for the specific purpose under Section 11(2) is applied to purposes other than charitable or religious, or ceases to be accumulated or set apart for application thereto, it will be chargeable to tax as income of that year. Further, such accumulated income will become liable to be taxed if,
- (ii) it ceases to remain invested in any security or deposited in the manner provided under Section 11(5), or
- (iii) it is not utilised for the purpose for which it is so accumulated or set apart during the specified period, or in the year immediately following the expiry thereof;

- (iv) is credited or paid to any trust or institution registered under Section 12AA or to any fund or institution or trust or any university or other educational institution or any hospital or other medical institution referred to in sub-clause (iv) or sub-clause (v) or sub-clause (vi) or sub-clause (via) of clause (23C) of Section 10.

it shall be deemed to be the income of the previous year in which it ceases to remain so invested or deposited or is not so utilised, as the case may be.

Section 11(3A) provides that where due to circumstances beyond the control of the person in receipt of the income, any income invested or deposited in accordance with the provisions of Section 11(2) cannot be applied for the purpose for which it was accumulated or set apart, the Assessing Officer may, on an application made to him in this behalf allow such person to apply such income for such other charitable or religious purpose in India, as is specified by the person in the application subject further to the condition that it is in conformity with the objects of the trust.

Provided that the Assessing Officer shall not allow application of such income by way of payment or credit made for the purposes referred to in clause (d) of Sub-section (3) of section 11.

For the purposes of Section 11, 'property held under trust' includes a business undertaking so held and where a claim is made that the income of any such undertaking shall not be included in the total income of the persons in receipt thereof, the Assessing Officer shall have power to determine the income of such undertaking in accordance with the provisions of the Income-tax Act relating to assessment and where any income so determined is in excess of the income as shown in the accounts of the undertaking, such excess shall be deemed to be applied to purposes other than charitable or religious.

Provided that the Assessing Officer shall not allow application of such income by way of payment or credit made for the purposes referred to in clause (d) of Sub-section (3) of Section 11:

Provided further that in case the trust or institution, which has invested or deposited its income in accordance with the provisions of clause (b) of Sub-section (2), is dissolved, the Assessing Officer may allow application of such income for the purposes referred to in clause (d) of Sub-section (3) in the year in which such trust or institution was dissolved.

Sub-section (4A) as substituted by Finance Act, 1991 with effect from 1.4.1992 states that Sub-sections (1) or (2) or (3) or (3A) of Section 11 shall not apply in relation to any business income of a trust or institution unless the business is incidental to the attainment of the objectives of the trust or institution and separate books of accounts are maintained by such trust or institution in respect of such business.

Forms and Modes of Investment [Section 11(5)]

The forms and modes for investing funds of charitable and religious trusts and institutions are given hereunder:

- (i) investment in saving certificates as defined in clause (c) of Section 2 of the Government Savings Certificates Act, 1959 (46 of 1959), and any other securities or certificates issued by the Central Government under the Small Savings Schemes of that Government. Investments in Indira Vikas Patra and Kisan Vikas Patra also qualify for the purpose of this Section;
- (ii) deposit in any account with the Post Office Savings Bank;
- (iii) deposit in any account with a scheduled bank or a co-operative society engaged in carrying on the business of banking (including a co-operative land mortgage bank or a co-operative land development bank);

Explanation: In this clause, "scheduled bank" means the State Bank of India constituted under the State Bank of India Act, 1955 (23 of 1955), a subsidiary bank as defined in the State Bank of India (Subsidiary Banks) Act, 1959 (38 of 1959), a corresponding new bank constituted under Section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970), or under Section 3 of the

Banking Companies (Acquisition and Transfer of Undertaking) Act, 1980 (40 of 1980), or any other bank being a bank included in the Second Schedule to the Reserve Bank of India Act, 1934 (2 of 1934);

- (iv) investment in units of the Unit Trust of India established under the Unit Trust of India Act, 1963 (52 of 1963);
- (v) investment in any security for money created and issued by the Central Government or a State Government;
- (vi) investment in debentures issued by, or on behalf of, any company or corporation both the principal whereof and the interest whereon are fully and unconditionally guaranteed by the Central Government or by a State Government;
- (vii) investment or deposit in any public sector company;

Provided that where an investment or deposit in any public sector company has been made and such public sector company ceases to be a public sector company:

- (A) such investment made in the shares of such company shall be deemed to be an investment made under this clause for a period of three years from the date on which such public sector company ceases to be a public sector company;

Investment in debt instruments issued by an infrastructure Finance Company registered with RBI.

- (B) such other investment or deposit shall be deemed to be an investment or deposit made under this clause for the period up to the date on which such investment or deposit becomes repayable by such company;

- (viii) deposits with or investment in any bonds issued by a financial corporation which is engaged in providing long-term finance for industrial development in India and which is eligible for deduction under clause (viii) of Sub-section (1) of Section 36;

- (ix) deposits with or investment in any bonds issued by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance or construction or purchase of houses in India for residential purposes and which is approved by the Central Government for the purposes of clause (viii) of Sub-section (1) of Section 36;

- (ixa) deposits with or investment in any bonds issued by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for urban infrastructure in India.

Explanation: For the purpose of this clause:

- (a) "long-term finance" means any loan or advance where the terms under which moneys are loaned or advanced provide for repayment along with interest thereof during a period of not less than five years;
- (b) "public company" shall have the meaning assigned to it in Section 3 of the Companies Act, 1956 (1 of 1956);
- (c) "urban infrastructure" means a project for providing potable water supply, sanitation and sewerage, drainage, solid waste management, roads, bridges and flyovers or urban transport.
- (x) investment in immovable property.

Explanation: "Immovable property" does not include any machinery or plant (other than machinery or plant installed in a building for the convenient occupation of the building) even though attached to, or permanently fastened to, anything attached to the earth;

- (xi) deposits with the Industrial Development Bank of India established under the Industrial Development Bank of India Act, 1964 [(18 of 1964)];

- (xii) any other form or mode of investment or deposit as may be prescribed including investments in units of Mutual Fund and Transfer of Deposits to Public Account of India.

Income from Voluntary Contributions (Section 12)

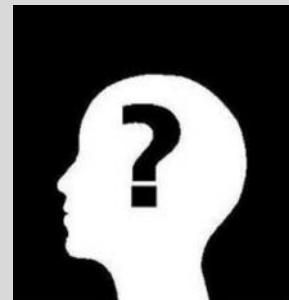
(1) The income of a trust by way of voluntary contributions would also be treated for all purposes as income deemed to have been derived by the trust from property held by it under trust except, however, in case where the voluntary contribution is received with a specific direction that it shall form part of the corpus of the trust. As a result, voluntary contribution received by a trust should also be applied for charitable purposes before the end of the accounting year or within 3 months following so that income-tax exemption could be availed of. However, voluntary contributions could be accumulated for future obligation for charitable purposes in the same manner as specified earlier.

(2) The value of any services, being medical or educational services, made available by any charitable or religious trust running a hospital or medical institution or an educational institution, to any person referred to in Clause (a) or Clause (b) or Clause (c) or Clause (cc) or Clause (d) of Sub-section (3) of Section 13, shall be deemed to be income of such trust or institution derived from property held under trust wholly for charitable or religious purposes during the previous year in which such services are so provided and shall be chargeable to income-tax notwithstanding the provisions of Sub-section (1) of Section 11.

Explanation: For the purposes of this sub-section, the expression “value” shall be the value of any benefit or facility granted or provided free of cost or at concessional rate to any person referred to in Clause (a) or Clause (b) or Clause (c) or Clause (cc) or Clause (d) of Sub-section (3) of Section 13.

(3) Notwithstanding anything contained in Section 11, any amount of donation received by the trust or institution in terms of Clause (d) of Sub-section (2) of Section 80G which has been utilised for purposes other than providing relief to the victims of earthquake in Gujarat or which remains unutilised in terms of Sub-section 5(C) of Section 80G in respect of which accounts of income and expenditure have not been rendered to the authority prescribed under clause (v) of sub-section (5C) of that section, in the manner specified in that clause, and not transferred to the Prime Minister's National Relief Fund on or before the 31st day of March, 2004 shall be deemed to be the income of the previous year and shall accordingly be charged to tax.

Test Your Knowledge



2. Income in the form of voluntary contribution made with a specific direction that they shall form part of the corpus of the trust or institution shall be fully exempt?

- True
- False

Income to be included in Total Income [Section 13(1)]

The exemption granted by Sections 11 or 12 of the Act would not, however, be available in the following cases and circumstances:

- (a) Where any part of the income from property held under trust for private religious purposes does not enure for the benefit of the public;
- (b) In the case of a trust for charitable purposes or an institution created or established for charitable purposes on or after 1.4.1962, any income of the trust will not qualify for tax exemption if the trust or institution is created or established for benefit of any particular religious community or caste. By virtue of

explanation 2 to Section 13, any trust created for the benefit of Scheduled Castes, backward classes, or Scheduled Tribes or women or children would not be deemed to be a trust or institution created or established for the benefit of any particular religious community or caste for purposes of this exemption. Consequently, income derived by trusts or institutions established purely for the benefit of scheduled castes or tribes or backward classes or women or children would qualify for tax exemption even though the income is applied in reality for the benefit of a particular community or caste.

- (c) In the case of a trust or institution established after 1.4.1962 or in the case of a trust, whenever created or established, if the income of the trust or institution is applied during the accounting year, directly or indirectly for benefit of any of the specified persons or if under the terms of the trust or the rules governing that institution, any part of the income of the trust enures for the benefit of such specified persons, whether directly or indirectly, the trust would not be given tax exemption under Section 11, with the exception that (i) where such use or application is by way of compliance with a mandatory term of the trust or a mandatory rule governing the institution, and (ii) where such use or application relates to any period before the 1st day of June, 1970, the aforementioned provision shall not apply.
- (d) Where any business is owned by a religious or charitable trust or institution, the income of such business shall be determined by the Assessing Officer in the same way as the assessment of business income of any other assessee. Consequently, any additions to the business income shown in the accounts of the assessee made by the Assessing Officer is deemed to be income applied by the trust for purposes other than charitable or religious. Such additions, therefore, do not qualify for tax exemptions under Section 11(4).

However, in the case of a trust or institution established before 1.4.1962, the exemption would not be forfeited merely on the ground that a part of the income or property of the trust or institution is applied directly or indirectly for the benefit of the specified persons if such use or application is for compliance with a mandatory term of the trust or a mandatory rule governing the institution.

For purposes of the disallowance of exemption, the 'specified persons' are the following namely:

- (i) the author of the trust or the founder of the institution,
- (ii) any person who has made a substantial contribution to the trust or institution, that is to say, any person whose total contribution up to the end of the relevant previous year exceeds ₹ 25,000,
- (iii) where the author, founder or other substantial contributor is a Hindu Undivided Family, any member of the family,
- (iv) any trustee of the trust or manager, by whatever name called, of the institution,
- (v) any relative of such author, founder, person, member, trustee or manager, referred to above, and
- (vi) any concern in which any of the above mentioned persons has a substantial interest.

The expression 'relative' used for this purpose has been defined in the Explanation (1) to Section 13 to mean:

- (i) the spouse of the individual,
- (ii) brother or sister of the individual,
- (iii) the brother or sister of the spouse of the individual,
- (iv) any lineal ascendant or descendant of the individual,
- (v) any lineal ascendant or descendant of the spouse of the individual, and
- (vi) the spouse of any of the persons referred to in (ii) to (v) above and any lineal ascendant or descendant of a brother or sister of either the individual or the spouse of the individual.

The income or the property of the trust or institution or any part thereof shall be deemed to have been used or applied for the benefit of the specified persons and consequently the trust will forfeit its exemption from income-tax in the following cases specified in Section 13(2):

- (i) Where any part of the income or property of the trust or institution is, or continues to be lent to any of the specified persons for any period during the previous year without either adequate security or adequate interest or both;
- (ii) If any land, building or other property of the trust or institution is or continues to be made available for the use of any of the specified persons for any period during the previous year without charging adequate rent or other compensation;
- (iii) If any amount is paid by way of salary, allowance or otherwise during the previous year to any of the specified persons out of the resources of the trust or institution for service rendered by that person to such trust or institution and the amount so paid is in excess of what may reasonably be paid for such service;
- (iv) If the services of the trust or institution are made available to any of the specified persons during the previous year without adequate remuneration or other compensation;
- (v) If any security, share or other property is purchased by or on behalf of the trust or institution from any of the specified persons during the previous year for a consideration which is more than adequate;
- (vi) If any share, security or other property is sold by or on behalf of the trust or institution to any of the specified persons during the accounting year for a consideration which is less than adequate;
- (vii) If any income or property of the trust or institution is diverted during the previous year in favour of any of the specified persons. However, if the total value of the income and/or property so diverted does not exceed ₹ 1,000 in value, the trust will not forfeit the exemption merely because any portion of the income or property of the trust is diverted for the benefit of any of the specified persons; and
- (viii) If any funds of the trust or the institution are, or continue to remain, invested for any period during the accounting year in any concern in which any of the specified persons has a substantial interest.

For purposes of disallowance of the exemption to a charitable trust or institution the specified persons shall be deemed to have a substantial interest in a concern under the following circumstances:

- (i) In case where the concern is a company - if its equity shares carrying not less than 20% of the total voting power are, at any time during the previous year, owned beneficially by such person or partly by such person and partly by one or more of the other specified persons, or
- (ii) In the case of any other concern - if such specified persons are entitled individually or jointly to not less than 20% of the profits of such concern at any time during the relevant accounting year.

Where the trust funds are invested in a concern in which any of the specified persons has a substantial interest and the quantum of the investment does not exceed 5% of the capital of the concern, the exemption shall not be allowed in respect of the income arising from such investment and the remaining income will continue to enjoy exemption from tax.

Further for debentures of an Indian company/Corporation acquired by the trust/institution after 28 February, 1983 but before 25th July, 1991, the exemption from tax under Section 11 or Section 12 shall be allowed to the trust/institution in respect of interest on such debentures if the trust/institution disinvests such debentures latest by 31st March, 1992

Any charitable or religious trust or institution will forfeit exemption from tax if any funds of the trust or institution are invested or deposited, after February 28, 1983, otherwise than in any one or more of the modes specified in Section 11(5). Such trusts and institutions will also forfeit exemption from tax if any part of their funds invested before March 1, 1983 otherwise than in any one or more of the forms or modes specified in Section 11(5) continue to remain so invested or deposited after November 30, 1983. Trusts or institutions which continue to hold any shares in a company (other than a Government company or a statutory corporation) after the said date will also forfeit exemption from income-tax.

The aforesaid provisions will, however, not apply in relation to assets which constituted the original corpus of the trust or institution as on June 1, 1973 and any accretion to the assets being shares of a company forming part of the corpus of the trust or institution as on June 1, 1973, where such accretion arises by way of bonus shares. The aforesaid provisions will also not apply in relation to assets (being debentures issued by a company) acquired by the trust/institution before March 1, 1983. Further, it will not apply in relation to any asset [other than an investment or deposit in the mode or form as specified in Section 11(5)] which is held after the expiry of one year from the end of the previous year in which such asset is acquired or the 31st Day of March, 1993 whichever is later in the mode and form as specified in Section 11(5). Also, it will not apply in relation to any funds representing the profits and gains of business relevant to the assessment year 1984-85 or any subsequent year.

Notwithstanding anything contained in Sub-section (1) or Sub-section (2), but without prejudice to the provisions contained in Sub-section (2) of Section 12, in the case of a charitable or religious trust running an educational institution or a medical institution or a hospital, the exemption under Section 11 or Section 12 shall not be denied in relation to any income, other than the income referred to in Sub-section (2) of Section 12, by reason only that such trust has provided educational or medical facilities to persons referred to in Clause (a) or Clause (b) or Clause (c) or Clause (cc) or Clause (d) of Sub-section (3).

If the trust or institution has any other income in addition to profits and gains of business, for getting exemption under this clause separate books of account in respect of such business are to be maintained.

Business income of charitable trusts: The exemption from income- tax will not be denied to any religious or charitable trust in respect of profits or gains of business, provided that:

- (a) the business is carried on by a trust wholly for public religious purposes and the business consists of printing and publication of books or is of a kind notified by the Government, or
- (b) the business is carried on by an institution wholly for charitable purposes and the work in connection with the business is mainly carried on by the beneficiaries of the institution and, separate books of account are maintained by the trust/institution of such business.

As per Section 13(7), nothing contained in Section 11 or 12 shall operate so as to exclude from the total income of the previous year of the person in receipt thereof, any anonymous donation referred to in Section 115BBC on which tax is payable in accordance with the provisions of that section.

A new sub-section (8) to section 13 has been inserted by the Finance Act, 2012 which provides that nothing contained in section 11 or section 12 shall operate so as to exclude any income from the total income of the previous year of the person in receipt thereof if the provisions of the first proviso to clause (15) of section 2 become applicable in the case of such person in the said previous year.

Conditions as to Registration of Trusts, etc. (Section 12A)

The provisions of Sections 11 and 12 shall not apply in relation to any trust or institution unless the following conditions are fulfilled:

- (a) The person in receipt of the income has made an application for registration of the trust or institution in the prescribed form and manner with the Chief Commissioner or Commissioner of Income-tax before 1st day of July, 1973 or before the expiry of a period of one year from the date of creation of the trust or the establishment of the institution whichever is later;

However, as per a change in Section 12A done by Finance Act, 1999 on and from 1st June 1999 an application for registration of the trust or institution has to be made only to the Commissioner.

Where however, an application is made after the period as aforesaid the provisions of Sections 11 and 12 will apply from the date of the creation of the trust or the establishment of the institution if the commissioner is satisfied that the person in receipt of income was prevented from making an application for registration within the aforesaid period for sufficient reasons. If however, the Commissioner is not satisfied, the provisions of Sections 11 and 12 will apply from the 1st day of the financial year (i.e. the previous year) in which the application is made.

- (b) Where the total income of the trust or institution before giving effect to the provisions of Sections 11 and 12 exceeds fifty thousand rupees in any previous year and the accounts of the trust or the institution are audited by a chartered accountant and a copy of the auditors report in the prescribed form and verified in the prescribed manner is submitted alongwith the return of income for the relevant assessment year.
- (c) Where the total income of the trust or institution as computed under this Act without giving effect to the provisions of Sections 11 and 12 exceeds one crore rupees in any previous year, the trust or institution:
 - (i) publishes its accounts in a local newspaper, before the due date for furnishing the return of income under Sub-section (4A) of Section 139; and
 - (ii) furnishes a copy of such newspaper along with such return.

Rule 17A of the Income-tax Rules, 1962 provides that an application for registration of a trust shall be made in duplicate in Form No. 10A and shall be accompanied by the following documents:

- (i) where the trust is created or the institution is established under an instrument, the instrument in original together with a copy thereof and where it is created otherwise than under an instrument, the document evidencing the creation of the trust or the establishment of the institution together with one copy thereof. The Chief Commissioner or Commissioner may accept a certified copy instead of the original where the original cannot be conveniently produced.
- (ii) where the trust is in existence during any year or years prior to the financial year in which the application for registration is made, two copies each of the accounts of the trust for the three years (immediately) preceding the years in which the application for which the accounts have been made-up.

In terms of Section 12AA, on receipt of application for registration, the Chief Commissioner or Commissioner shall call for such documents or information from the trust or institution as he thinks necessary in order to satisfy himself about the genuineness of activities of the trust or institution and may also make such inquiries as he may deem necessary in this behalf. Sub-section 12AA is amended by Finance Act, 1999 w.e.f. 1.6.99 so as to provide that an order on an application for registration of a trust or institution is to be made by the Commissioner only and not by the Chief Commissioner. He has to either grant or decline registration within six months from the end of the month in which the application was received. Also Sub-section (1A) is inserted in Section 12AA so as to provide that all applications pending before the Chief Commissioner on which no order has been made by him before 1st June, 1999 shall stand transferred from 1st June, 1999 to the Commissioner and the Commissioner may proceed with such application under Sub-section (1) from the stage at which it was on that day.

Where the commissioner is satisfied that the activities of the trust or institution are not genuine or are not carried out in accordance with the objects of the trust or institution then the commissioner may pass an order in writing for the cancellation of registration granted under section 12AA or under section 12A after giving an opportunity of being heard.(Inserted by the Finance Act, 2010, w.e.f. 1-6-2010.)

TAX EXEMPTIONS TO POLITICAL PARTIES (SECTION 13A)

‘Political party’ means an association or body of individual citizens of India registered with the Election Commission of India as a political party and includes a political party deemed to be registered with that Election Commission of India.

Political parties are liable to pay tax on their income and they are assessed as ‘An association of persons’. However, the income derived by these parties as income by way of voluntary contributions, Income from House Property; and Income from Other Sources or Capital Gains are exempt from subject to the following conditions:

- (i) the party keeps and maintains such books of account and other documents as would enable the Assessing Officer to properly deduce the income;
- (ii) in respect of each such voluntary contribution in excess of ₹ 20,000, the party keeps and maintains a record of the contributions and names and addresses of the persons who have made such contribution; and
- (iii) the accounts of the party are audited by a Chartered Accountant or other qualified accountant.

The Chief Executive Officer of the political party is required to file a return of income if the total income (computed under this Act without giving effect to the provisions of Section 13A) exceeds the maximum amount which is not chargeable to income-tax. In this connection, the provisions of Section 139(1) shall apply.

VOLUNTARY CONTRIBUTIONS RECEIVED BY AN ELECTORAL TRUST (SECTION 13B)

Any voluntary contributions received by an electoral trust shall not be included in the total income of the previous year of such electoral trust, if

- (a) such electoral trust distributes to any political party, registered under section 29A of the Representation of the People Act, 1951, during the said previous year, ninety-five per cent of the aggregate donations received by it during the said previous year along with the surplus, if any brought forward from any earlier previous year; and
- (b) such electoral trust functions in accordance with the rules made by the Central Government.

‘Electoral Trust’ means a trust so approved by the Board in accordance with the scheme made in this regard by the Central Government.

LESSON ROUND UP

- This Lesson discusses the incomes enumerated under section 10 which are not included in the net total income of the assessee.
- This Lesson also deals with the special provisions with regard to newly established Industrial Undertakings in Special Economic Zones.
- Moreover this Lesson discusses about income from property held for trusts, charitable and religious purposes.
- It also deals with income of the political parties

SELF TEST QUESTIONS

These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation.

MULTIPLE CHOICE QUESTIONS

1. Which of the following income is agricultural income –

- (a) Rent received from agricultural land
- (b) Income from dairy farm
- (c) Income from poultry farm
- (d) Dividend from a company engaged in agriculture.

2. Income accruing from agriculture in a foreign country is taxable in the case of an assessee who is –

- (a) Resident
- (b) Not-ordinarily resident
- (c) Non-resident
- (d) None of the above.

3. Which of the following income is an agriculture income-

- (a) Income from brick making

- (b) income from agriculture land situated in Pakistan
 - (c) Prize from government on account of higher crop yield
 - (d) Compensation received from insurance company on account of loss of crop.
4. Under section 10(10), the maximum amount of gratuity received which is not chargeable to tax shall be;
- (a) ₹ 3,50,000
 - (b) ₹ 3,00,000
 - (c) ₹ 2,50,000
 - (d) ₹ 10,00,000
5. Leave encashment is exempt to the extent of maximum of the following:
- (a) ₹ 3,50,000
 - (b) ₹ 3,00,000
 - (c) ₹ 10,00,000
 - (d) ₹ 2,50,000

FILL IN THE BLANKS

1. Remuneration earned by a member of HUF for the services rendered by him is _____ as income of the member.
2. The HRA paid to an employee residing in Lucknow is exempt upto the lower of actual HRA or, excess of rent paid over 10% of salary or _____ of salary.
3. The income of minor child shall be taxable in excess of _____ in the hands of parents.
4. Under section 2(22AAA), _____ means a trust so approved by the Board in accordance with the scheme made in this regard by the Central Government.

TRUE AND FALSE

1. Prize given to Suhesh by the Government of Madhya Pradesh on account of higher crop yield is an agricultural income.
2. Voluntary contribution received by electoral trust shall be exempt in all cases.
3. An income derived from land situated in India is agricultural income.
4. Literary Awards instituted by the Central Government are exempted from income tax.
5. Income in the form of voluntary contribution made with a specific direction that they shall form part of the corpus of the trust or institution shall be fully exempt.

SHORT NOTES

1. Treatment of agricultural income for tax purposes
2. Income of political parties
3. Casual Income
4. Death-cum- retirement gratuity
5. House rent allowance
6. Dividend.

DISTINGUISH BETWEEN

1. Free Trade zone and Special Economic Zone

ELABORATIVE

1. State the conditions which are essential to support a claim for exemption of income of public charitable trust under Section 11 of the Income-tax Act, 1961.
2. Enumerate the privileges conferred on a foreign technician by the Income-tax Act, 1961 and the conditions to be fulfilled for eligibility of the concessions.
3. What are the provisions relating to exemption of income of a political party? Discuss.
4. What are the conditions to be satisfied to enable the Electoral Trust to claim full exemption?
5. What are the benefits available to a 100 per cent export oriented unit? Describe the eligibility conditions for availing such benefits under Section 10B of the Act.

Practical Questions

1. Discuss any three of the following incomes which do not form part of total income under the Income-tax Act, 1961:
 - (a) Retrenchment compensation,
 - (b) Sum received under a Life Insurance Policy
 - (c) Subsidy received from Tea Board, and
 - (d) Income of a Local Authority.
2. Bazaar Ltd. exports articles and has furnished the following particulars for the previous year 2012-13

Export sales	₹ 60,00,000
Domestic sales	₹ 20,00,000
Total Sales	₹ 80,00,000
Money brought to India in convertible foreign exchange	₹ 50,00,000
Profits from business	₹ 16,00,000

You are required to compute the exemption available under section 10A for the Assessment Year 2013-14.

ANSWERS/HINTS**Multiple choice question**

1. (a); 2. (a); 3. (d); 4. (d); 5. (b)

Fill in the Blank

1. Exempt; 2. 40%; 3. ₹ 1,500; 4. Electoral trust

True and False

1. False; 2. False; 3. True; 4. True; 5. False

Practical questions

1. (a), (b), (c)

2. ₹10,00,000

Test your knowledge

1. False 2. True

SUGGESTED READINGS

1. Dr. V.K. Singhania : Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.

2. Girish Ahuja and Ravi Gupta : Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.

Lesson 4

Computation of Total Income under various Heads:

Part I – Income under the Head Salaries

LESSON OUTLINE

- Basis of Charge
- Salary [Section 17(1)]
- Allowances
- Perquisites [Section 17(2)]
 - (A) Tax-free perquisites (in all cases)
 - (B) Taxable perquisites (in all cases)
 - (C) Perquisites taxable only in the cases of Specified Employees
- Valuation of Perquisites
- Rent-free/Concessional rent residential accommodation [Rule 3(1)]
- Profits in Lieu of or in Addition to Salary
- Deductions Allowed from Salaries (Section 16)
- Provident funds - Treatment of Contributions to and Money Received from the Provident Fund
- Incomes exempt from Tax and not includable in 'Salary'
- Performa of Computing Taxable Salary
- Illustrations
- Lesson Round Up
- Self Test Question

LEARNING OBJECTIVES

The taxability of income of a person depends on the chargeability of such income under the Income tax Act 1961. The total income of an assessee (subject to statutory exemptions) is chargeable under Section 4(1). The scope of the total income, which varies with the residential status, is defined in Section 5. Section 14 enumerates the heads of income under which the income of an assessee will fall. The rules for computing income and the permissible deductions under different heads of income, are dealt in different sections of the Act. The heads of income, along with their corresponding set of sections for the purpose of computation of income, are given below :

- (A) Salaries (Sections 15 to 17);
- (B) Income from house property (Sections 22 to 27);
- (C) Profits and gains of business or profession (Sections 28 to 44D);
- (D) Capital gains (Sections 45 to 55A); and
- (E) Income from other sources (Sections 56 to 59).

At the end of this lesson, you will learn how to calculate income under the head salaries, what are the deductions, exemptions available from salaries.

All income received as salary under Employer – Employee relationship is taxed under this head. On due or receipt basis, whichever arises earlier. Employers must withhold tax compulsarily (subject to section 192), if income exceeds minimum exemption limit, as tax deducted at source (TDS), and provide their employees Form 16 which shows the total amount of tax deducted from his net income.

BASIS OF CHARGE

As per Section 15, the income chargeable to income tax under the head salaries would include :

Any salary due to an employee from an employer or a former employer during the previous year irrespective of the fact whether it is paid or not.

Any salary paid or allowed to the employee during the previous year by or on behalf of an employer, or former employer, would be taxable under this head even though such amounts are not due to him during the accounting year

Arrears of salary paid or allowed to the employee during the previous year by or on behalf of an employer or a former employer would be chargeable to tax during the previous year in cases where such arrears were not charged to tax in any earlier year.

However it would not include:

- *Any salary paid in advance and included in the total income of any person for any previous year, shall not be included again in the total income of the person when the salary becomes due.*
- *Any salary, bonus, commission or remuneration, by whatever name called, due to, or received by, a partner of a firm from the firm shall not be regarded as "salary" for the purposes of this section.*

Due Basis of Taxation

The basis of taxation of income from salary is normally on 'due' basis. Thus, salary due to an employee is taxable regardless of the fact whether he actually receives it or not. Exceptions to this rule are of cases where salary is received in advance by an employee which is chargeable to tax as and when it is received although the salary is not due to him. But in order to ensure that there is no double taxation of the same item of income in the hands of the same employee, the explanation to Section 15 specifically provides that where an item of a salary income received by an employee in advance is taxed as and when it is received, it shall not again be charged to tax when it becomes due to the assessee. In order to attract liability to tax under this head, it is not essential that the employee, who is liable to tax under this head, must receive salary from his present employer.

Illustration: Yana is an employee of Tara Pvt. Ltd. getting a salary of ₹ 40,000 per month which becomes due on the last day of the month but is paid on the 7th of next month. Salary for which months will be taxable for AY 2014-15?

Solution: The salary for the months of April 2013 to March 2014 will be taxable for the the Assessment Year 2014-15 because salary for April 2013 will be due on 30th April, 2013 (i.e. within the same month).

Illustration: Mr. X is an employee of Y Ltd. His salary is ₹ 25,000 per month. Salary becomes due on last day of each month. In March, 2014, he received salary of April and May in Advance. Compute taxable amount for AY 2014-15 and AY 2015-16.

Solution: Taxable Salary for AY 2014-15 (PY 2013-14):

- Salary for the months of April, 2013 to March, 2014 will be taxable on due basis.
- Salary for the month of April 2014 and May, 2014 will also be taxable on receipt basis. Therefore, it will not be taxable in AY 2015-16 on receipt basis.
- Thus, taxable salary for AY 2014-15 = ₹ 25,000*12 + ₹ 25,000*2 = ₹ 3,50,000

Taxable Salary for AY 2015-16 (PY 2014-15):

- Salary for the month of June, 2014 to March, 2015 will only be taxable on due basis. Salary for April and May 2014 will not be taxable as that has already been taxed on receipt basis in the AY 2014-15.

Thus, taxable salary for AY 2015-16 = ₹ 25,000*10 = ₹ 2,50,000

Computation of Salary in the Grade System

An employee may be entitled to receive salary in grade system. Under this system, the normal annual increments to be given to the employee are already fixed in the grade. For example, if an employee joins the service on 1.6.2010 and is placed in the grade of ₹ 10,000-1,000-15,000-2,000-25,000 then his salary from 1.6.2010 will be ₹ 10,000 p.m. and thereafter his salary will be ₹ 11,000 p.m. w.e.f. 31.5.2011 until it reaches ₹ 15,000 after which it will increase annually by ₹ 2,000 until it reaches ₹ 25,000. After that, employee will be placed in another grade. In certain cases, employee joins in the grade at a salary in between the grade, in that case his salary will annually increase in the aforesaid manner the only difference would be that his initial salary would be a different amount than the start of the grade.

Illustration: A joins the service in the grade of 10,000-1000-15,000-2,000-25,000 on 01.08.2010 at a salary of ₹ 13,000. Compute taxable salary for AY 2014-15.

Solution: Computation of Taxable Salary for Previous Year 2013-14 (1-4-2013 to 31-3-2014):

Salary from 1.8.2010 to 31.7.2011 : ₹ 13,000 p.m.

Salary from 1.8.2011 to 31.7.2012 : ₹ 14,000 p.m.

Salary from 1.8.2012 to 31.7.2013 : ₹. 15,000 p.m.

Salary from 1.8.2013 to 31.7.2014 : ₹ 17,000 p.m.

Salary for Previous year 2013-14 will be divided into two parts:

Salary from 1.4.2013 to 31.7.2013 = 15,000 * 4 = ₹ 60,000

Salary from 1.8.2013 to 31.3.2014 = 17,000 * 8 = ₹ 1,36,000

Total Salary for P.Y. 2013-14 = ₹ 1,96,000

Employer and Employee Relationship

The salary of an employee is a separate source, distinct from other classes of income. The basis of liability under the head salaries is the employer-employee relationship. Before charging the particular income received by a person under this head, care must be taken to ensure that there exists such a relationship of employer and employee between the recipient and the payer of the income. The payments chargeable under the head salaries must be made between the persons who are in the relationship of employer and employee. Therefore, the amount received by an individual shall be treated as salary only if the relationship between payer and payee is of an employer and employee or master and servant. Employer may be an individual, firm, and association of persons, company, corporation, Central Government, State Government, public body or a local authority. Likewise, employer may be operating in India or abroad. The employee may be full time employee or part-time employee.

The question whether a particular person receives the income in his capacity as an employee or not has to be decided from the facts of each case.

Let's examine the following cases, whether payments are chargeable under head salaries;

- (i) The professor of university would be receiving income by way of monthly salary from the university which is chargeable to tax under this head. But this does not mean that every item of income received by the employee from his employer would be taxable under this head. Thus, income by way of examinership fees received by a professor from the same university in which he is employed would not be chargeable to tax under this head but must be taxed as Income from other sources under Section 56. This is because of the fact that the essential condition that the income in question must be received for services rendered in the ordinary course of employment would not be fulfilled in the case of examinership fees.
- (ii) A director of a company may, in some cases, be an employee of a company where there is a specific contract of employment between him and the company. The fact that the same person has dual capacity in his relationship with the company does not mean that he cannot be taxed under this head. Every item of income arising to such a director who is also an employee of the company (e.g. a managing director or other whole-time director) by virtue of his employment would be taxable as his income from salary. Thus, income by way of remuneration received by a managing director would be taxable as his salary income whereas the income received by him as director's fees in his capacity as director for attending the meetings of the Board would be assessable under the head "Income from other sources".
- (iii) An official liquidator appointed by the Court or by the Central Government would also become an employee of the Central Government under Section 448 of the Companies Act, 1956 and consequently the remuneration due to him would also be assessable under the head 'Salaries'.
- (iv) Remuneration received by a manager of a company even if he is wrongly designated as a director or by any other name would be chargeable to tax under this head regardless of the fact that the amount is payable to him monthly or is calculated at a certain percentage of the company's profits.
- (v) Salary paid to a partner by a firm is nothing but appropriation of profits. Any salary, bonus, commission, or remuneration by whatever name called due to or received by partner of a firm shall not be regarded as salary but has to be charged as income from business. It is because of the fact that the relationship between the firm and its partner is not of employer and employee.
- (vi) According to a circular of the Board dated 22-5-1967, the salary received by a person as Member of Parliament will not be chargeable to income-tax under the head "Salaries" but as "Income from other sources" because a Member of Parliament is not an employee of the Government but only an elected representative of the people.
- (vii) The income received by a treasurer of a bank would be taxable as his salary income if the treasurer is an employee of the bank. If he does not happen to be an employee, the income received by him would be taxable as "Income from other sources". For this purpose, the question whether in a particular case the treasurer is an employee or not has to be decided on the basis of the facts and circumstances of each case having due regard to his powers, responsibilities and functions.
- (viii) Income derived by any person from carrying on a profession or vocation must be taxed as business income and not as salary income because employment is different from profession.

But, if an employee receives any money from his employer as part of the terms of employment for not carrying on any profession, such income must be taxed as salary income. For instance, the allowance given by employer to a doctor employed by him for not carrying on a profession in addition to the employment would be income arising from employment in accordance with the terms and conditions of such employment and must, therefore, be taxed as salary income. If an employee gets money from persons other than his employer and if such money is not in any way related to the contract of services

with the employer under whom he is working, the receipts, if taxable as income, must be assessed under the head "Income from other sources".

However, gratuity, bonus, commission or other items of payment made by the employer without any specific stipulation in the contract of employment to this effect, would still be taxable as salary, because they are paid by the employer for the services rendered by the employee. The fact that such payments are voluntary and in certain circumstances may qualify for exemption from income-tax in the hands of the employee, would not affect the income being computed under the head salary.

SALARY RECEIVED FROM FORMER EMPLOYER

Even salaries received by an employee from former employer(s) for services rendered would be chargeable to tax under this head. Hence, the fact that the employee in question is not an employee under the person from whom the money is received at the time of its receipt, is irrelevant. Arrears of salaries are chargeable to tax as the income of the year in which such arrears are received if they are not charged to tax at the time of becoming due.

Other points for consideration for taxability of salary

- (1) Any lump sum amount paid to an employee by his employer in commutation, reduction or substitution of salary, pension or other type of income from employment, is nevertheless taxable as income from salary in the year in which such payment falls due or is received by the employee, whichever is earlier. Section 200 of the Companies Act totally prohibits any company from paying tax-free remuneration to any of its employees.
- (2) For purposes of computing the income taxable under this head, the gross salary due to the employee should be taken as the basis. Thus, any tax deducted at source or other deductions on account of provident fund, insurance premium, or on any other account made by the employer from the salary income, should be added to the net salary received by the employee. The fact that some of the deductions like provident fund or insurance premium may qualify for any deduction from gross total income in the personal assessment of the employee, does not, in any way, affect the quantum of salary due to the employee.
- (3) Any salary voluntarily surrendered by the employee on or after 1-4-1961 to the Central Government under the provisions of the Voluntary Surrender of Salaries (Exemption from Taxation Act), 1961, would not be treated as income taxable in the hands of the employee. In all other cases, the salary foregone voluntarily or otherwise surrendered by the employee, would still be chargeable to tax although the employee may not receive that income. No tax exemption is available for surrender of salaries for the simple reason that the amount surrendered constitutes merely an application of income which is immaterial for the purpose of taxing the employee.

If the foregoing or surrender of salary represents a donation for charitable purpose, the employee may qualify for deduction from gross total income under Section 80G of the Act. However, salary foregone before it becomes due cannot be taxed [C.I.T. v. Mehar Singh Sampuran Singh Chawla (1973) 90 ITR 219]. Further, where in reality there is no agreement to pay any salary, the apparent foregoing of a fictional salary would not attract tax.

- (4) Where a person, out of missionary spirit, agrees to work as principal in an institution without accepting any salary from the institution, and in the school accounts his salary is shown as an item of expenditure, while the same amount is entered in the receipts as a donation by the management in a separate cash book meant for exclusive use for the management only, these entries are book entries only and no money is actually paid to him; hence, taking into consideration the special circumstances of the case, the fictional salary would not be taxable [Reade v. Brearley (1933) 17 TC 687].

- (5) Salary is taxable even if the money is not received or could not be recovered from the employer due to his insolvency or any other reason. The expenses, if any, incurred by the employee to take legal proceedings against his employer for its recovery would not also be allowed as a deduction from the income assessable in his hands. This is because of the fact that the actual receipt of the income is immaterial for purpose of its taxation.
- (6) It is immaterial whether the employer is Government or a private employer. Further, the salary may be paid by a foreign Government to its employees serving in India, and this salary is taxable under the head "Salaries".
- (7) The leave salary paid to the legal heirs of the deceased employee in respect of privilege leave standing to the credit of such employee at the time of his/her death is not taxable as salary. It is an ex gratia payment on compassionate grounds in the nature of gift. Thus, the payment is not in the nature of a salary (Letter from C.B.D.T. dated 5-11-1965 and circular No. 309 dated 3-7-1981).

SALARY [SECTION 17(1)]

"Salary" includes :

- (i) Wages or Salary: 'Salary' is generally used in respect of payment for services of a higher class, whereas 'wages' is confined to the earnings of labourers. However, for income-tax purposes there is no difference between salary and wages.
- (ii) Annuity is annual grant made by the employer to the employee.
- (iii) Pension is a periodical payment for past services.
- (iv) Gratuity is a lump sum payment for past services.
- (v) Fees and Commission: It is a remuneration to encourage employees.
- (vi) Perquisites: These include all benefits and amenities provided by the employer to the employee, either in cash or kind.
- (vii) Profit in lieu of or in addition to salary or wages.
- (viii) Advance of Salary.
- (ix) Any payment received by an employee in respect of any period of leave not availed of by him.
- (x) Taxable portion of annual accretion: Where the employee is a member of a Recognised Provident Fund, the amount contributed by the employer in this fund in excess of 12 per cent of the salary of the employee and interest credited on the amount of the fund in excess of the prescribed rate of interest is to be included in the salary income.
- (xi) Taxable portion of transferred balance: When an unrecognised provident fund is recognised for the first time, the balance in the unrecognised provident fund is known as "Transferred balance". The employer's share (contribution in unrecognised provident fund and interest on employer's share) is included in the salary income for income-tax purposes at the time of such transfer.
- (xii) The contribution made by the Central Government in the previous year, the account of any employee under a pension scheme referred to in Section 80CCD.

Important Notes :

- (1) Advance salary is taxable on receipt basis in the previous year in which it is received. The recipient can, however, claim relief under Section 89(1) read with Rule 21A.
- (2) Arrears salary is taxable on receipt basis subject to the fact that it has not been taxed on accrual basis earlier. The recipient can claim relief in terms of Section 89(1) read with Rule 21A.
- (3) Encashment of leave salary (before retirement) is taxable on receipt basis but relief can be claimed under Section 89(1). However, such salary received at the time of retirement is exempt subject to Section 10(10AA).
- (4) Pension received by a person from the employer after his retirement is taxed as salary. The pension can be either uncommuted or commuted. Commuted pensions received by government employees are wholly exempt under Section 10(10A). In case of non-Government employees, commuted value of one-third of pension which he is normally entitled to receive is exempt from tax if the employee receives gratuity. In other cases, one-half of commuted value of pension is exempt.
- (5) Instalments re-paid under Additional Emoluments (C.D.) Act, 1974 are taxable as arrear of salary in the previous year in which the same are received. However, relief under Section 89(1) can be claimed.

ALLOWANCES

An allowance is defined as a fixed amount of money given periodically in addition to the salary for the purpose of meeting some specific requirements connected with the service rendered by the employee or by way of compensation for some unusual conditions of employment. It is taxable on due/accrued basis whether it is paid in addition to the salary or in lieu thereon. These allowances are generally taxable and are to be included in the gross salary unless a specific exemption has been provided in respect of allowances provided under the following sections:

- (a) House Rent Allowances – Section 10(13A): Covered under Lesson 3.
- (b) Special Allowance – Section 10(14)(i) & (ii): Covered under Lesson 4.

Fully Taxable Allowances

(1) **Dearness Allowance, Additional Dearness Allowance and Dearness Pay:** This is a very common allowance these days on account of high prices. Sometimes Additional Dearness Allowance is also given. It is included in the income from salary and is taxable in full. Sometimes it is given under the terms of employment and sometimes without it. When it is given under the terms of employment it is included in salary for purposes of determining the exemption limits of house rent allowance, recognised provident fund, gratuity and value of rent free house and is also taken into account for the purposes of retirement benefits.

Sometimes dearness allowance is given as 'Dearness Pay'. It means that it is being given under the terms of employment.

- (2) **Fixed Medical Allowance:** It is fully taxable.
- (3) **Tiffin Allowance:** It is given for lunch and refreshments to the employees. It is taxable.
- (4) **Servant Allowance:** It is fully taxable even if it is given to a low paid employee, not being an officer, i.e., it is taxable for all categories of employees.
- (5) **Non-practising Allowance:** It is generally given to those medical doctors who are in government service and they are banned from doing private practice. It is to compensate them for this ban. It is fully taxable.

(6) **Hill Allowance:** It is given to employees working in hilly areas on account of high cost of living in hilly areas as compared to plains. It is fully taxable, if the place is located at less than 1,000 metres height from sea level.

(7) **Warden Allowance and Proctor Allowance:** These allowances are given in educational institutions for working as Warden of the hostel and/or working as Proctor in the institution. These allowances are fully taxable.

(8) **Deputation Allowance:** When an employee is sent from his permanent place of service to some other place or institution or organisation on deputation for a temporary period, he is given this allowance. It is fully taxable.

(9) **Overtime Allowance:** When an employee works for extra hours over and above his normal hours of duty he is given overtime allowance as extra wages. It is fully taxable.

(10) **Other Allowances** like Family allowance, Project allowance, Marriage allowance, City Compensatory allowance, Dinner allowance, Telephone allowance etc. These are fully taxable.

Allowances not fully taxable

(a) **Special allowances for performance of official duty [section 10(14)(i)]:** These allowances are specifically granted to meet expenses wholly and exclusively incurred in the performance of official duty. These are exempt to the extent such expenses are actually incurred or the amount received whichever is less. These allowances are Travelling allowance, Daily allowance, Helper allowance, Academic Allowance, Uniform Allowance etc. All these allowances are **discussed in detail under Lesson 3.**

(b) **Allowance to meet personal expenses :**

- Allowances which are granted to meet personal expenses are exempt to the extent of amount received or the limits specified whichever is less. These allowances are Children education allowance, Hostel Expenditure allowance, Tribal area, Schedule area/agency area allowance, special compensatory hilly area allowance or high altitude allowance etc., Border area, remote area allowance or disturbed area allowance etc., Compensatory, modified field area allowance, Counter insurgency allowance granted to members of armed forces, Transport allowance etc. These allowances are discussed in detail in Lesson 3.
- Allowances which are granted to meet personal expense are exempt to the fixed percentage of amount received. These allowances are allowed to transport employees working in any transport system.

Treatment of Entertainment Allowance

In case of Entertainment allowance an assessee will not get any exemption but would be eligible for deduction under section 16(ii) from gross salary. The deduction is allowed to government employees only; Non- Government employees will not be eligible for this deduction. The entire amount of entertainment allowance will be added to gross salary.

The minimum of the following shall be available as deduction in case of Government employees:

- (i) Actual amount of entertainment allowance received during the year
- (ii) 20% of his salary exclusive of any allowance, benefit or other perquisites.
- (iii) ₹5,000.

PERQUISITES [SECTION 17(2)]

The term “perquisites” includes all benefits and amenities provided by the employer to the employee in addition

to salary and wages either in cash or in kind which are convertible into money. These benefits or amenities may be provided either voluntarily or under service contract. For income-tax purposes, the perquisites are of three types:

- (A) Tax-free perquisites
- (B) Taxable perquisites
- (C) Perquisites taxable under specified cases.

The term "Perquisite" is defined by section 17(2) as follows:

- (i) the value of rent-free accommodation provided to the assessee by his employer;
- (ii) the value of any concession in the matter of rent respecting any accommodation provided to the assessee by his employer;

Explanation 1. – For the purposes of this sub-clause, concession in the matter of rent shall be deemed to have been provided if,—

- (a) in a case where an unfurnished accommodation is provided by any employer other than the Central Government or any State Government and –
 - (i) the accommodation is owned by the employer, the value of the accommodation determined at the specified rate in respect of the period during which the said accommodation was occupied by the assessee during the previous year, exceeds the rent recoverable from, or payable by, the assessee;
 - (ii) the accommodation is taken on lease or rent by the employer, the value of the accommodation being the actual amount of lease rental paid or payable by the employer or fifteen per cent of salary, whichever is lower, in respect of the period during which the said accommodation was occupied by the assessee during the previous year, exceeds the rent recoverable from, or payable by, the assessee;
- (b) in a case where a furnished accommodation is provided by the Central Government or any State Government, the licence fee determined by the Central Government or any State Government in respect of the accommodation in accordance with the rules framed by such Government as increased by the value of furniture and fixtures in respect of the period during which the said accommodation was occupied by the assessee during the previous year, exceeds the aggregate of the rent recoverable from, or payable by, the assessee and any charges paid or payable for the furniture and fixtures by the assessee;
- (c) in a case where a furnished accommodation is provided by an employer other than the Central Government or any State Government and –
 - (i) the accommodation is owned by the employer, the value of the accommodation determined under sub-clause (i) of clause (a) as increased by the value of the furniture and fixtures in respect of the period during which the said accommodation was occupied by the assessee during the previous year, exceeds the rent recoverable from, or payable by, the assessee;
 - (ii) the accommodation is taken on lease or rent by the employer, the value of the accommodation determined under sub-clause (ii) of clause (a) as increased by the value of the furniture and fixtures in respect of the period during which the said accommodation was occupied by the assessee during the previous year, exceeds the rent recoverable from, or payable by, the assessee;
- (d) in a case where the accommodation is provided by the employer in a hotel (except where the assessee

is provided such accommodation for a period not exceeding in aggregate fifteen days on his transfer from one place to another), the value of the accommodation determined at the rate of twenty-four per cent of salary paid or payable for the previous year or the actual charges paid or payable to such hotel, whichever is lower, for the period during which such accommodation is provided, exceeds the rent recoverable from, or payable by, the assessee.

Explanation 2. – For the purposes of this sub-clause, value of furniture and fixture shall be ten per cent per annum of the cost of furniture (including television sets, radio sets, refrigerators, other household appliances, air-conditioning plant or equipment or other similar appliances or gadgets) or if such furniture is hired from a third party, the actual hire charges payable for the same as reduced by any charges paid or payable for the same by the assessee during the previous year.

Explanation 3. – For the purposes of this sub-clause, “salary” includes the pay, allowances, bonus or commission payable monthly or otherwise or any monetary payment, by whatever name called, from one or more employers, as the case may be, but does not include the following, namely:–

- (a) dearness allowance or dearness pay unless it enters into the computation of superannuation or retirement benefits of the employee concerned;
- (b) employer’s contribution to the provident fund account of the employee;
- (c) allowances which are exempted from the payment of tax;
- (d) value of the perquisites specified in this clause;
- (e) any payment or expenditure specifically excluded under the proviso to this clause.]

Explanation 4. – For the purposes of this sub-clause, “specified rate” shall be –

- (i) fifteen per cent of salary in cities having population exceeding twenty-five lakhs as per 2001 census;
- (ii) ten per cent of salary in cities having population exceeding ten lakhs but not exceeding twenty-five lakhs as per 2001 census; and
- (iii) seven and one-half per cent of salary in any other place;]
- (iii) the value of any benefit or amenity granted or provided free of cost or at concessional rate in any of the following cases –
 - (a) by a company to an employee who is a director thereof;
 - (b) by a company to an employee being a person who has a substantial interest in the company;
 - (c) by any employer (including a company) to an employee to whom the provisions of paragraphs (a) and (b) of this sub-clause do not apply and whose income under the head “Salaries” (whether due from, or paid or allowed by, one or more employers), exclusive of the value of all benefits or amenities not provided for by way of monetary payment, exceeds fifty thousand rupees:]

Explanation. – For the removal of doubts, it is hereby declared that the use of any vehicle provided by a company or an employer for journey by the assessee from his residence to his office or other place of work, or from such office or place to his residence, shall not be regarded as a benefit or amenity granted or provided to him free of cost or at concessional rate for the purposes of this sub-clause;

- (iv) any sum paid by the employer in respect of any obligation which, but for such payment, would have been payable by the assessee;
- (v) any sum payable by the employer, whether directly or through a fund, other than a recognised provident fund or an approved superannuation fund or a Deposit-linked Insurance Fund established under

section 3G of the Coal Mines Provident Fund and Miscellaneous Provisions Act, 1948 (46 of 1948), or, as the case may be, section 6C of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 (19 of 1952)], to effect an assurance on the life of the assessee or to effect a contract for an annuity;

- (vi) the value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer, or former employer, free of cost or at concessional rate to the assessee.

Explanation. – For the purposes of this sub-clause, –

- (a) “specified security” means the securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) and, where employees' stock option has been granted under any plan or scheme therefor, includes the securities offered under such plan or scheme;
- (b) “sweat equity shares” means equity shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called;
- (c) the value of any specified security or sweat equity shares shall be the fair market value of the specified security or sweat equity shares, as the case may be, on the date on which the option is exercised by the assessee as reduced by the amount actually paid by, or recovered from, the assessee in respect of such security or shares;
- (d) “fair market value” means the value determined in accordance with the method as may be prescribed;
- (e) “option” means a right but not an obligation granted to an employee to apply for the specified security or sweat equity shares at a predetermined price;
- (vii) the amount of any contribution to an approved superannuation fund by the employer in respect of the assessee, to the extent it exceeds one lakh rupees; and
- (viii) the value of any other fringe benefit or amenity as may be prescribed:

Provided that nothing in this clause shall apply to, –

- (i) the value of any medical treatment provided to an employee or any member of his family in any hospital maintained by the employer;
- (ii) any sum paid by the employer in respect of any expenditure actually incurred by the employee on his medical treatment or treatment of any member of his family—
 - (a) in any hospital maintained by the Government or any local authority or any other hospital approved by the Government for the purposes of medical treatment of its employees;
 - (b) in respect of the prescribed diseases or ailments, in any hospital approved by the Chief Commissioner having regard to the prescribed guidelines:

Provided that, in a case falling in sub-clause (b), the employee shall attach with his return of income a certificate from the hospital specifying the disease or ailment for which medical treatment was required and the receipt for the amount paid to the hospital;

- (iii) any portion of the premium paid by an employer in relation to an employee, to effect or to keep in force an insurance on the health of such employee under any scheme approved by the Central Government or the Insurance Regulatory and Development Authority established under sub-section (1) of section 3 of the Insurance Regulatory and Development Authority Act, 1999 (41 of 1999).] for the purposes of clause (ib) of sub-section (1) of section 36;

- (iv) any sum paid by the employer in respect of any premium paid by the employee to effect or to keep in force an insurance on his health or the health of any member of his family under any scheme approved by the Central Government or the Insurance Regulatory and Development Authority established under sub-section (1) of section 3 of the Insurance Regulatory and Development Authority Act, 1999 (41 of 1999), for the purposes of section 80D;
- (v) any sum paid by the employer in respect of any expenditure actually incurred by the employee on his medical treatment or treatment of any member of his family [other than the treatment referred to in clauses (i) and (ii)]; so, however, that such sum does not exceed fifteen thousand rupees in the previous year;
- (vi) any expenditure incurred by the employer on –
 - (1) medical treatment of the employee, or any member of the family of such employee, outside India;
 - (2) travel and stay abroad of the employee or any member of the family of such employee for medical treatment;
 - (3) travel and stay abroad of one attendant who accompanies the patient in connection with such treatment, subject to the condition that—
 - (A) the expenditure on medical treatment and stay abroad shall be excluded from perquisite only to the extent permitted by the Reserve Bank of India; and
 - (B) the expenditure on travel shall be excluded from perquisite only in the case of an employee whose gross total income, as computed before including therein the said expenditure, does not exceed two lakh rupees;]
- (vii) any sum paid by the employer in respect of any expenditure actually incurred by the employee for any of the purposes specified in clause (vi) subject to the conditions specified in or under that clause :

Provided further that for the assessment year beginning on the 1st day of April, 2002, nothing contained in this clause shall apply to any employee whose income under the head "Salaries" (whether due from, or paid or allowed by, one or more employers) exclusive of the value of all perquisites not provided for by way of monetary payment, does not exceed one lakh rupees.

Explanation. – For the purposes of clause (2), –

- (i) "hospital" includes a dispensary or a clinic or a nursing home;
- (ii) "family", in relation to an individual, shall have the same meaning as in clause (5) of section 10; and
- (iii) "gross total income" shall have the same meaning as in clause (5) of section 80B;

(A) Tax-free perquisites (in all cases)

The value of the following perquisites is not to be included in the salary income of an employee :

- (i) **Medical Facilities:**
 - (a) The value of any Medical facility provided to an employee or his family member in any hospitals, clinics, etc. maintained by the employer.
 - (b) Reimbursement of expenditure actually incurred by the employee on medical treatment for self or for his family members in any hospitals, dispensaries etc. maintained by the Government or local authority or in a hospital approved under the Central Health Scheme or any similar scheme of the state Government or in a hospital, approved by the chief commissioner having regard to the prescribed guidelines for the purposes of medical treatment of the prescribed diseases or ailments.

- (c) Group medical insurance obtained by the employer for his employees (including family members of the employees) or all medical insurance payments made directly or reimbursement of insurance premium to such employees who take such insurance.
- (d) Reimbursement of medical expenses actually incurred by the employee upto a maximum of ₹ 15,000 in the aggregate in a year, in a private hospital for his and his family.
- (e) Any expenditure incurred or paid by the employer on the medical treatment of the employee or any family member of the employee outside India, the travel and stay abroad of such employee or any family member of such employee or any travel or stay abroad of one attendant who accompanies the patient in connection with such treatment will not be included in perquisites of the employee. However, the travel expenditure shall be excluded from the perquisites only when the employee's gross total income as computed before including the said expenditure does not exceed two lakh rupees and further to such conditions and limits as the Board may prescribe having regard to guidelines, if any, issued by the Reserve Bank of India.

(ii) **Refreshment :**

The value of refreshment provided by the employer during office hours and in office premises is fully exempt. Free Meals provided by the employer during working or business hours or through paid non transferable (usable only at eating joints) voucher if its value thereof in either case does not exceed ₹50 will not be treated as income of the employee. However, free meals provided by the employer during working hours in a remote area or an offshore installation shall be fully exempt.

(iii) **Subsidized lunch or dinner provided by employer:**

With effect from assessment year 1996-97, expenditure incurred by employer on provision of food or beverages to employees either inside or outside the place of work during working hours upto ₹ 35 per day per employee will not be treated as income of the employee provided the amount is paid by the employer directly to the caterer, restaurant, eating place, canteen, etc. (Circular: Nos. 708, dated 18.7.1995 and 727, dated 27.10.1995 issued by CBDT).

(iv) **Recreational facilities:**

The value of recreational facilities provided is exempt. However, the facility should not be restricted to a selected few.

- (v) **Telephone facility** provided at the residence of the employee is exempt to the extent of the amount of telephone bills paid by the employer when it is used for official and personal purposes of the employee.
- (vi) **The value of transport** provided by the employer to the employees as a group (and not to any individual or a few employees alone) from their place of residence to the place of work and back in the case of an employer engaged in the business of carriage of goods or passengers, to his employees either free of charge or at a concessional rate. Also from the assessment year 1990-91, conveyance facility provided for the journey between office and residence and back at free of charge or at concessional rate.
- (vii) **Personal accident insurance:** Payment of annual premium by employer on personal accident policy effected by him to his employee.
- (viii) **Refresher Course:** Where the employee attends any refresher course in management and the fees are paid by the employer, the amount spent by employer for the purpose.
- (ix) **Free rations:** The value of free rations given to the armed forces personnel.
- (x) **Family planning:** The amount spent by an employer on the promotion of family planning amongst its employees.

- (xi) **Sale of an asset** (being a movable asset but other than car, electronic items) or gift of such asset to an employee after using the same by the employer for 10 years or more is a perquisite in the hands of employee.
- (xii) Perquisites to Government employees being citizens of India, posted abroad.
- (xiii) **Rent-free house** to High Court Judges [High Court Judges (Conditions of Service) Act, 1954].
- (xiv) **Rent-free house** to Supreme Court Judges [Supreme Court Judges (Conditions of Service) Act, 1958].
- (xv) **Conveyance facility** to High Court and Supreme Court judges.
- (xvi) **Privilege passes and privilege ticket** orders granted by Railways to its employees.
- (xvii) Sum payable by an employer through a Recognised Provident Fund or an Approved Superannuation Fund or Deposit-linked Insurance Fund established under the Coal Mines Provident Fund or the Employees' Provident Fund.
- (xviii) Sum payable by an employer to pension or deferred annuity scheme.
- (xix) Employer's contribution to staff group insurance scheme.
- (xx) **Actual travelling expenses** paid/reimbursed by the employer for journeys undertaken by employees for business purposes.
- (xxi) **Leave travel concession** exempt as per provision of Section 10.
- (xxii) **Free holiday trips** to non-specified employees.
- (xxiii) **Rent-free furnished residence** (including maintenance thereof) provided to an Officer of Parliament, a Union Ministry and a leader of opposition in Parliament.
- (xxiv) **Goods sold to employees**, by their employer, at concessional rates.
- (xxv) **The value of any benefit** provided by a company free of cost or at a concessional rate to its employees by way of allotment of shares, debentures or warrants directly or indirectly under the Employees' Stock Option Plan or Scheme of the said company.
- (xxvi) **Free educational facility** to the children of the employee in an educational institute owned/maintained by the employer if cost of such education or value of such benefit does not exceed ₹ 1,000/- per month per child.
- (xxvii) **Interest free loan** to an employee if the amount of loan does not exceed ₹ 20,000/- or if loan is provided for specified diseases.
- (xxviii) **Computer/laptops** (provided only for use, ownership is retained by the employer).

One cannot be said to allow a perquisite to an employee if the employee has no right to the same. It cannot apply to contingent payment to which the employee has no right till the contingency occurs.

(B) Taxable perquisites (in all cases)

The value of the following perquisites is added to the salary income of the employee:

- (i) Value of rent-free residential accommodation provided to the assessee (except to the Judge of a High Court or Supreme Court; an Officer of Parliament, a Union Minister and a leader of opposition in Parliament).
- (ii) Value of any concession in the matter of rent in respect of residential accommodation provided to the assessee.

- (iii) Sum paid by the employer (directly or indirectly) for effecting an assurance on the life of the employee or for providing an annuity. If the amount is paid to a recognised provident fund or an approved superannuation fund, or to a deposit linked insurance fund established under the Coal Mines Provident Fund Act or Employees' Provident Fund Act, the sum so paid is not to be included in the salary income.
- (iv) Sum paid by the employer in respect of any obligation of the assessee, which would otherwise have been payable by the assessee. Some of the examples of such expenses are as follows :
 - (a) Income-tax paid by the employer due from the employee.
 - (b) Payment of club bills, club subscription or hotel bills of the employee.
 - (c) Fees paid by the employer directly to the school or reimbursement of tuition fees of the children of the employee.
 - (d) Payment of any loan due to the employee.
- (v) The value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer, or former employer, free of cost or at concessional rate to the assessee.
 - (a) "specified security" means the securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 and, where employees' stock option has been granted under any plan or scheme therefor, includes the securities offered under such plan or scheme;
 - (b) "sweat equity shares" means equity shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called;
 - (c) the value of any specified security or sweat equity shares shall be the fair market value of the specified security or sweat equity shares, as the case may be, on the date on which the option is exercised by the assessee as reduced by the amount actually paid by, or recovered from the assessee in respect of such security or shares;
 - (d) "fair market value" means the value determined in accordance with the method as may be prescribed;
 - (e) "*option*" means a right but not an obligation granted to an employee to apply for the specified security or sweat equity shares at a predetermined price;
- (vi) The amount of any contribution to an approved superannuation fund by the employer in respect of the assessee, to the extent it exceeds one lakh rupees;
- (vii) The value of any other fringe benefit or amenity as may be prescribed.

Some other examples of taxable perquisites are as follows :

- (a) Any reward awarded. For example, a professional jockey receives present from his employer on winning the race.
- (b) Any legal charges incurred by the employer to save or defend the employee. For instance, if an employee knocks down a pedestrian during the course of employment or otherwise while driving the company's car due to his negligence and, to defend his case in the court, the employer incurs heavy expenses, the amount spent by him on this account would represent a perquisite. It is likely that the actual expenditure incurred by the employer might be much larger than what the employee himself would have done if he were to take up the proceedings himself. Even in such cases, the perquisite chargeable to tax would be the entire amount spent by the employer and not only a portion thereof which the employee would have spent if he had himself taken up the legal proceedings in the court. Thus, the cost of legal defence of a criminal charge or civil litigation expenses incurred by the employer

on behalf of the employee even in his own interest for the purpose of retaining the services of the employee would be taxable as perquisite.

(C) Perquisites taxable only in the cases of Specified Employees

The value of certain benefit or amenity granted or provided free of cost or at a concessional rate in any of the following cases only shall be included in the salary income:

- (a) by a company to an employee who is director thereof [It is immaterial whether the director is full time or part time director];
- (b) by a company concern to an employee, being a person who has a substantial interest in the company concern, i.e., employee is the beneficial owner of at least 20 per cent of the equity shares of that company or is entitled to atleast 20 per cent share is profit of the concern;
- (c) an employee whose income chargeable under head salaries (exclusive of the value of all benefits or amenities not provided by way of monetry payments) excess ₹ 50,000, is a specified employee.

Some of the examples of such perquisite which are included in the salary income of a specified employee as defined above are:

- (i) Free boarding facility provided by employer.
- (ii) Free conveyance for private use.
- (iii) Free education facility to the family members of employee.
- (iv) Holiday trips at employer's cost.
- (v) Gas, electricity or water supplied free for household consumption.
- (vi) Wages of domestic servants paid by employer.
- (vii) Free lunches or dinners.

Note: From 1.4.1990 the use of any vehicle provided by a company or an employer for journey by the assessee from his residence to his office or other place of work, or from such office or place to his residence, shall not be regarded as a benefit or amenity granted or provided to him free of cost or at concessional rate for the purpose of computation of perquisite.

Valuation of Perquisites

The basic principles governing valuation of perquisites are as follows :

- The valuation is done on the basis of their value to the employee and not the employer's cost for providing the same - Wilkins v. Rogerson (1963) 49 ITR 395 (CA).
- The value of perquisite is included in the salary income only if the perquisite is actually provided to the employee.
- Perquisite which is not actually enjoyed by the employee (though the terms of employment provide for the same) cannot be valued and taxed in the employee's hands. Therefore, where the employee waives his right of perquisite, he cannot be taxed thereon.

The valuation of various perquisites is done as follows :

Rent-free/Concessional rent residential accommodation [Rule 3(1)]			
Sl. No.	Circumstances	Where the accommodation is unfurnished	Where the accommodation is furnished
(1)	(2)	(3)	(4)
(1)	Where the accommodation is provided by Union or State Government to their employees either holding office or post in connection with the affairs of Union or the State or serving with any body or undertaking under the control of such Government on deputation.	License fee determined by Union or State Government in respect of accommodation in accordance with the rules framed by that government as reduced by the rent actually paid by the employee.	The value of perquisite as determined under col. 3 and increased by 10% p.a. of the cost of furniture (including television sets, radio sets, refrigerators, other household appliances, air conditioning plant or equipment) or if such furniture is hired from a third party, the actual hire charges payable for the same as reduced by any charges paid or payable for the same by the employee during the previous year.
(2)	Where the accommodation is provided by any other employer and (a) where the accommodation is owned by the employer, or (b) Where the accommodation is taken on lease or rent by the employer.	(a)(i) 15% of salary in cities having population exceeding 25 lakh as per 2001 census. (ii) 10% of salary in cities having population exceeding ₹10 lakh but not exceeding ₹25 lakh as per census of 2001, (iii) 7.5% of salary on other cities, in respect of the period during which the said accommodation was occupied by the employee during the previous year as reduced by the rent, if any, actually paid by the employee. (b) Actual amount of lease rental paid or payable by the employer or 15% of salary whichever is lower as reduced by the rent, if any, actually paid by the employee.	The value of perquisite as determined under col. 3 and increased by 10% p.a. of the cost of furniture (including television sets, radio sets, refrigerators, other household appliances, air-conditioning plant or equipment or other similar appliances or gadgets) or if such furniture is hired from a third party, the actual hire charges payable for the same as reduced by any charges paid or payable for the same by the employee during the previous year.
(3)	Where the accommodation is provided by the employer specified in Sl. (1) or (2) above in a hotel (except where the employee is provided such accommodation for a period not exceeding in aggregate 15 days on the transfer from one place to another)	Not applicable	24% of salary paid or payable for the previous year or the actual charges paid or payable to such hotel, which is lower, for the period during which such accommodation is provided as reduced by the rent, if any, actually paid or payable by the employees.

Provided that nothing contained in this sub-rule would be applicable to any accommodation located in a 'remote area' provided to an employee working at a mining site or an onshore oil exploration site, or a project execution site or an accommodation provided in an offshore site of similar nature.

Provided further that where on account of his transfer from one place to another, the employee is provided with accommodation at the new place of posting while retaining the accommodation at the other place, the value of perquisite shall be determined with reference to only one such accommodation which has the lower value with reference to the Table above for a period not exceeding 90 days and there after the value of perquisite shall be charged for both such accommodations in accordance with the Table.

Valuation of perquisite in respect of motor car

The valuation of perquisite in respect of motor car provided to the employee shall be calculated in different situations in different ways such as car may be used by the employee wholly for business use or used partly for personal use or partly for business use. The calculation of value of perquisites is shown in this table as follows:

Sl. No.	Circumstances	Value of perquisites
1.	WHERE CAR IS OWNED BY THE EMPLOYEE A. When car expenses are met by the employee B. When running and maintenance expenses are met or reimbursed by the employer (i) If the car is used wholly for official purposes (ii) If the car is used wholly for private purposes (iii) If the car is partly used for official purposes and partly for private purposes.	A. It is not a perquisite, hence not taxable. B.(i) in this case, no value of perquisite shall be added provided the employer has maintained complete documents of journey undertaken. B. (ii) value of perquisite shall be actual expenditure incurred by the employer less amount recovered from the employee. B. (iii) Value of perquisite shall be actual expenditure incurred by the employer less amount used for official purposes i.e @1800 per month where the cubic capacity of the engine does not exceed 1.6 litres or ₹2400 if such capacity exceeds 1.6 litres and ₹900 p.m if chauffeur is provided or higher amount as per records of the employer less amount recovered from the employee.
2.	WHEN CAR IS OWNED OR HIRED BY EMPLOYER A. When running and maintenance expenses are met or reimbursed by the employer (i) If the car is used wholly for official purposes (ii) If the car is used wholly for private purposes (iii) If the car is partly used for official purposes and partly for private purposes. B. When running and maintenance expenses of car are met by the employee (i) If the car is used wholly for official	A.(i) in this case, no value of perquisite shall be added provided the employer has maintained complete documents of journey undertaken. A.(ii) Value of perquisite shall be the actual expenditure incurred by the employer plus normal wear and tear @10% or hire charges if car is taken on hire less amount recovered from the employee. A.(iii) value of perquisite shall be ₹1800 p.m where the cubic capacity of the engine does not exceed 1.6 litres or ₹2400 p.m if such capacity

	<p>purposes</p> <p>(ii) If the care is used wholly for private purposes</p> <p>(iii) If the car is partly used for official purposes and partly for private purposes.</p>	<p>exceeds 1.6 litres and ₹900 p.m if chauffeur is provided.</p> <p>B. (i) It is not a perquisite, hence not taxable.</p> <p>B. (ii) Value of perquisite shall be 10% of the actual cost of car or hire charges if car is taken on hire plus salary of chauffeur if any paid or payable by the employer.</p> <p>B. (iii) value of perquisite shall be ₹600 p.m where the cubic capacity of the engine does not exceed 1.6 litres or ₹900 p.m if such capacity exceeds 1.6 litres and ₹900 p.m if chauffeur is provided.</p>
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Sweeper, Gardener, Watchman or a Personal Attendant (Sub-rule 3)

The value of benefit to the employee or any member of his household resulting from the provision of the employer of services or a sweeper, a gardener, a watchman or personal attendant, shall be the actual cost to the employer. The actual cost in such a case shall be the total amount of salary paid or payable by the employer or any other person on his behalf for such services as reduced by any amount paid by the employee for such services.

Gas, Electric Energy or Water (Sub-rule 4)

The value of benefit to the employee resulting from the supply of gas, electric energy or water for his household consumption shall be determined as the sum equal to the amount paid on that account by the employer to the agency supplying the gas, electric energy or water. Where such supply is made from the sources owned by the employer, without purchasing them from any other outside agency, the value of perquisites would be the manufacturing cost per unit incurred by the employer. Where the employee is paying any amount in respect of such services, the amount so paid shall be deducted from the value so arrived at.

Free or Concessional Education (Sub-rule 5)

The value of benefit to the employee resulting from the provision of free or concessional educational facilities for any member of his household shall be determined as the sum equal to the amount of expenditure incurred by the employer in that behalf of where the educational institution is itself maintained and owned by the employer or where free educational facilities for such member of employees' household are allowed in any other educational institution by reason of his being in employment of that employer, the value of the perquisite to the employee shall be determined with reference to the cost of such education in similar institution in or near the locality. Where any amount is paid or recovered from the employee on that account, the value of benefit shall be reduced by the amount so paid or recovered.

Provided that where the educational institution itself is maintained and owned by the employer and free educational facilities are provided to the children of the employee or where such free educational facilities are provided in any institution by reason of his being in employment of that employer, nothing contained in this sub-rule shall apply if the cost of such education or the value of such benefit per child does not exceed ₹ 1,000 p.m.

Other fringe benefits or amenities (Sub-rule 7)

In terms of provisions contained in sub-clause (vi) of Sub-section (2) of Section 17, the following other fringe benefits or amenities are hereby prescribed and the value thereof shall be determined in the manner provided thereunder;

(i) Interest free or concessional loan

The value of the benefit to the assessee resulting from the provision of interest-free or concessional loan made

available to the employee or any member of his household during the relevant previous year by the employer or any person on his behalf shall be determined as the sum equal to the simple interest computed at the rate charged by the State Bank of India in respect of loans for house and conveyance and at the rate charged by the State Bank of India for other loans on the maximum outstanding monthly balance as reduced by the interest, if any, actually paid by him or any such member of his household.

However, no value would be charged if such loans are made available for medical treatment in respect of diseases specified in rule 3A of these rules or where the amount of loans are petty not exceeding in the aggregate ₹ 20,000.

Provided that where the benefit relates to the loans made available for medical treatment referred to above the exemption so provided shall not apply to so much of the loan as has been reimbursed to the employee under any medical insurance scheme.

(ii) Use of any movable asset

The value of benefit to the employee resulting from the use by the employee or any member of his household of any movable asset (other than assets already specified in this rule and other than laptops and computers) belonging to the employer or hired by him shall be determined @ 10% p.a. of the actual cost of such asset or the amount of rent or charge paid or payable by the employer, as the case may be, as reduced by the amount, if any, paid or recovered from the employee for such use.

(iii) Transfer of any movable asset

The value of benefit to the employee arising from the transfer of any movable asset belonging to the employer directly or indirectly to the employee or any member of his household shall be determined to the amount representing the actual cost of such asset to the employer as reduced by the cost of normal wear and tear calculated at the rate of 10% of such cost for each completed year during which such asset was put to use by the employer and as further reduced by the amount, if any, paid or recovered from the employee being the consideration for such transfer.

Provided that in the case of computers and electronic items, the normal wear and tear would be calculated at the rate of 50% and in the case of motor cars at the rate of 20% by the reducing balance method (WDV).

Explanation to the Rule 3

Meaning of certain terms mentioned in rules for valuation of perquisites:

- (i) “**accommodation**” includes a house, flat, farm house or part thereof, or accommodation in a hotel, model, service apartment, guest house, caravan, mobile home, ship or other floating structure;
- (ii) “**entertainment**” includes hospitality of any kind and also expenditure on business gifts other than free samples of the employer own product with the aim of advertising to the general public;
- (iii) “**hotel**” includes licensed accommodation in the nature of motel, service apartment or guest house;
- (iv) “**member of household**” shall include:
 - (a) spouse(s)
 - (b) children and their spouses
 - (c) parents
 - (d) servants and dependants;
- (v) “**remote area**”, for the purposes of proviso to this sub-rule means an area that is located at least 40 kilometers away from a town having a population not exceeding 20,000 based on latest published all-India census;

- (vi) “**salary**” includes the pay, allowances, bonus or commission payable monthly or otherwise or any monetary payment, by whatever name called from one or more employers, as the case may be but does not include the following, namely:
- dearness allowance or dearness pay unless it enters into the computation of superannuation or retirement benefits of the employee concerned;
 - employer’s contribution to the provident fund account of the employee;
 - allowances which are exempted from payment of tax;
 - the value of perquisites specified in clause (2) of section 17 of the Income-tax Act;
 - any payment or expenditure specifically excluded under proviso to sub-clause (iii) of clause (2) or proviso to clause (2) of section 17;
- (vii) “**maximum outstanding monthly balance**” means the aggregate outstanding balance for each loan as on the last day of each month.

PROFITS IN LIEU OF OR IN ADDITION TO SALARY

Under this the following items are included :

(i) **The amount of any compensation due** to or received by an assessee from the employer or former employer at or in connection with the termination of his employment. The ‘termination of employment’ means retirement, premature termination of employment, termination by death or voluntary resignation. Generally, under the Income-tax Act, the income that is chargeable to tax is only a receipt which is revenue in nature; receipts of a capital nature are not chargeable to tax but this provision constitutes an exception to this rule because compensation received by an employee for termination of his employment would be a capital receipt since it is received in replacement of the sources of income itself. Still it is chargeable to tax because of the specific provision in the Act. However, relief under Section 89(1) would be available to the assessee in cases where he gets money which represents a profit in lieu of salary.

The amount of any compensation due to or received by any assessee from his employer in connection with the modification of the terms and conditions relating to employment. For example, where an employer wants to cut down the salary payable to the employee, the lump sum paid to compensate the employee shall be treated as profits in lieu of salary. In the same way, where the remuneration for services is paid at the end of the period of employment or a lump sum remuneration is paid at the beginning of employment for a number of years, such payment shall be treated as profits in lieu of salary.

(ii) Any amount due to or received, whether in lump sum or otherwise, by any assessee from any person - (A) before his joining any employment with that person; or (B) after cessation of his employment with that person.

(iii) Any payment other than the following payment due to or received by assessee from an employer or a former employer or from a provident or other fund, to the extent to which it does not consist of contribution by the assessee or interest on such contributions by the assessee or interest on such contributions or any sum under keyman Insurance Policy.

(1) Gratuity

Exceptions : The following shall not be included in the salary income :

- Death-cum-retirement gratuity received under :
 - The Revised Pension Rules of the Central Government;
 - The Central Civil Services (Pension) Rules, 1972;

- (iii) Any similar scheme applicable to the employees of Central, State or local authority;
- (iv) The pension code or regulations applicable to the members of the defence services.
- (b) Any gratuity received under the payment of Gratuity Act, 1972 to the extent it does not exceed an amount calculated in accordance with the provisions of Sub-sections (2) and (3) of Section 4 of that Act.
- (c) Any other gratuity received by an employee on his retirement, or on his becoming incapacitated or on termination of his employment or received by nominee on his death to the extent of half month's salary for each completed year of service calculated on the basis of the average salary for the ten months immediately preceding the month in which any such event occurs, subject to such limit (₹10,00,000 on retirement, death or termination on or after 24.05.10 vide notification no. 43/2010 dated 11.06.2010. Prior to this the limit was 3,50,000) as the Central Government may notify having regard to the limit applicable in that behalf to the employees of that Government.

Note: For details see "Income which do not Form part of total income" in Lesson 3.

(2) Commuted value of pension

- (a) In case of Government employees (Central, State, Local authority or statutory corporation), the full amount of commuted value of pension is exempted.
- (b) In case of non-Government employees, the exemption is as follows :
 - (i) where the employee receives any gratuity, the commuted value of one-third of the pension which he is normally entitled to receive;
 - (ii) where the employee does not receive any gratuity, the commuted value of one-half of such pension.

(3) Retrenchment compensation

Retrenchment compensation received by a workman under the Industrial Disputes Act, 1947 or any other Act or rules, orders or notifications issued thereunder or under any standing orders or under any award, contract of service or otherwise to the extent of the actual award or ₹ 5,00,000 the amount notified by the Central Government or the amount calculated u/s 25F(b) of the Industrial Disputes Act, 1947 whichever is less.

(4) Amount received from Statutory Provident Fund and/or Public Provident Fund/Recognised Provident Fund

The amount is exempt if the following conditions are satisfied :

- (i) he has rendered a continuous service with his employer for five years or more; or
- (ii) if he has not rendered such continuous service, the service has been terminated by reason of his ill health, or discontinuance or contraction of employer's business or any other cause beyond the control of employee; or
- (iii) on cessation of his employment, he obtains employment with any other employer and balance standing in his Recognised Provident Fund is transferred to his account in the Recognised Provident Fund maintained by the new employer.

Where the accumulated balance of recognised provident fund has been transferred to any other Recognised Provident Fund [under clause (iii)] then in computing the period of continuous service for clause (i) or clause (ii), the period or periods for which the employee rendered continuous service under his former employer or employers shall be included.

(5) House rent allowance received from the employer

The exempted amount shall not exceed :

- (a) actual amount of such allowance received in respect of the relevant period; or
 - (b) excess of rent paid or payable by the employee over ten per cent of salary (salary includes dearness allowance, if the terms of employment so provide, (and also commission if based on percentage on sales/turnover) but excludes all other allowances and perquisites) due in respect of the relevant period; or
 - (c) an amount equal to –
 - (i) Where such accommodation is situated at Mumbai, Calcutta, Delhi or Chennai, 50% of the amount of salary due to the assessee in respect of the relevant period; and
 - (ii) Where such accommodation is situated at any other place, 40% of the amount of salary due to the assessee in respect of the relevant period;
- (6) Remuneration for extra duties and voluntary payments to employees made by an employer, if such payments are made in reference to services rendered by virtue of employment, also constitutes profits in lieu of salary.

Note: For details, see “Incomes which do not form part of income” in Lesson 3.

DEDUCTIONS ALLOWED FROM SALARIES (SECTION 16)

The following amounts shall be deducted in order to arrive at the chargeable income under the head ‘Salaries’.

(A) Standard deduction: Omitted by Financial Act, 2005 w.e.f. 1.4.2006. – Section 16(i)

(B) Entertainment allowance : Where the employee is in receipt of entertainment allowance, the amount so received shall first be included in the salary income and thereafter the following deduction shall be made - Section 16(ii) :

16(ii). A deduction in respect of any allowance in the nature of an entertainment allowance specifically granted by an employer to the assessee who is in receipt of a salary from the Government, a sum equal to one-fifth of his salary (exclusive of any allowance, benefit or other perquisite) or five thousand rupees, whichever is less.

W.e.f. April 1, 2002 entertainment allowance will be allowed in computing income from salary only in case of employees of the Government and will cease to be allowable for persons other than those employed in Government i.e. entertainment allowance deduction will not be allowed to other employees.

Note: For this purpose ‘Salary’ excludes any allowance, benefit or other perquisites:

Where an employee, not entitled to claim deduction under this clause, spends some money on the entertainment of customers of the concern, the amount so spent cannot be deducted from the salary income. The condition makes exemption well-nigh impossible for the employees of private sector. For them, the better course would be to get the entertainment expenses reimbursed.

(C) Tax on employment or Professional Tax: From the assessment year 1990-91, deduction shall be allowed in respect of any sum paid by the assessee on account of a tax on employment within the meaning of clause (2) of article 276 of the Constitution, leviable by a State under any law passed by its legislature.

Where Professional/Employment tax is paid by the employer on behalf of the employee, it will first be included in his gross salary as a perquisite, being a monetary obligation of the employee discharged by the employer. Thereafter, a deduction on account of such professional tax shall be allowed to the employee from his gross salary. Professional tax due but not paid shall not be allowed as deduction.

PROVIDENT FUNDS - TREATMENT OF CONTRIBUTIONS TO AND MONEY RECEIVED FROM THE PROVIDENT FUND

For purposes of Income-tax, provident funds are grouped under three heads:

(A) Statutory provident fund

All provident funds which are set up under the Provident Funds Act, 1925 are called Statutory Provident Funds. Provident funds of institutions such as Universities, Colleges or other Educational Institutions, Reserve Bank of India, State Bank of India, the Central Government and State Government would constitute Statutory Provident Funds. In case of Statutory Provident Fund, the entire amount of employer's contribution without any limit or restriction whatsoever and the interest thereon received by the employee shall not be includable in the total income of the employee both at the time when the contribution is made and at the time when the money is received by or on behalf of the employee on his retirement, death or otherwise. This exemption is specifically conferred by Sub-section (11) of Section 10 of the Income-tax Act. The employee can contribute to this fund out of his salary as much as he likes.

(B) Recognised provident fund

All Provident Funds recognised by the Commissioner of Income-tax under Rule 3 of Part 'A' of the Fourth Schedule to the Income-tax Act, 1961 and also Provident Funds established under a scheme framed under the Employees Provident Funds Act, 1952 are known under the Income-tax Act as Recognised Provident Funds. For the purposes of being treated as Recognised Provident Fund, the Fund in question must be recognised by the Commissioner of Income-tax at the time of its setting up and must continue to be so recognised even subsequently. The moment the recognition is withdrawn by the Commissioner, the Fund ceases to be a Recognised Provident Fund. The Provident Funds of various Public Sector Undertakings, Semi-Government bodies and other institutions and organisations including companies which are recognised by the Commissioner for income-tax purposes, would be treated as Recognised Provident Funds. In the case of a Recognised Provident Fund, the employer's contribution to the Provident Fund is not treated as the employee's income so long as the contribution by the employer does not exceed 12% of the salary of the employee. But if the contribution of the employer exceeds 12% of the employee's salary, the excess of the contribution over 12% of the salary of the employee is to be treated as part of the taxable income from salaries in the hands of the employee in respect of the financial year in which the contributions were made by the employer. The fact that the employee concerned does not receive the money in hand nor is he entitled to get the money immediately does not in any way affect the taxability of the excess over 12% of the employee's salary. The employee's own contribution qualifies for deduction under Section 80C of the Income-tax Act. [Salary for this purpose, includes basic salary; dearness allowance/pay (if the terms of employment so provide) and commission (if based on a fixed percentage of turnover achieved by the employee)]. As regards interest on the contributions to the Provident Fund, only an amount exceeding a sum calculated at 12% per annum on the balance standing to the credit of the employee would be treated as part of the taxable income of the employee. In other words, so long as the amount of interest does not exceed this limit, the interest does not become chargeable to tax in the hands of the employee.

(C) Unrecognised provident Fund

The Provident Fund which is neither Statutory nor recognised by the Commissioner of Income-tax nor Public Provident Fund, would be an Unrecognised Provident Fund for income-tax purposes. In the case of an Unrecognised Provident Fund, the employee's own contribution to the Fund would not be allowed as a deduction. The employer's contribution and the interest thereon would, however, be exempt from tax as and when the contributions are being made. But when the money in lump sum is received back by the employee, that part of the amount attributable to the employer's contribution would be taxable as income from salaries and the interest on the employer's contribution would also be taxable as salary income in the hands of the employee. The employee's own contributions when received back would not be taxable because they do not contain an element of income. However, the interest thereon would be chargeable to tax as income from other sources and not as income from salaries.

INCOMES EXEMPT FROM TAX AND NOT INCLUDIBLE IN ‘SALARY’

The following items relevant to salaries have been discussed under Incomes which do not form part of total income at Lesson 3 of this material and are exempt from tax, subject to the limits applicable for each:

1. Leave Travel Allowance [Section 10(5)];
2. Remuneration of a person who is not a citizen of India [Section 10(6)].
3. Allowances payable outside India [Section 10(7)];
4. Remuneration of an employee working under the Co-operative Technical Assistance Programme [Section 10(8)];
5. Death-cum-retirement gratuity [Section 10(10)];
6. Amount received in commutation of Pension [Section 10(10A)];
7. Encashment of earned leave [Section 10(10AA)];
8. Retrenchment compensation [Section 10(10B)];
9. Payment received from Statutory Provident Fund [Section 10(11)];
10. Payment received from a recognised Provident Fund [Section 10(12)];
11. Payment received out of an approved Superannuation Fund [Section 10(13)];
12. House rent allowance [Section 10(13A)];
13. Special allowances to meet the expenses of the duties [Section 10(14)];
14. Salary income of a member of Scheduled Tribe [Section 10(26)];
15. Salary income of a resident of Ladakh [Section 10(26A)];

Tax Deducted at Source

Salaries payable by an employer are chargeable to tax in the hands of the employee and are subject to deduction of tax at source under Section 192 of the Income-tax Act. The obligation of the employer to deduct tax at source is mandatory and cannot be negotiated. But in cases where there is any failure on the part of the employer to deduct the tax at source, the employee cannot escape liability to tax; he would be chargeable to tax on his entire income from salaries. The fact that the employer could be proceeded against and be subjected to penalty or prosecution, would not absolve the employee of his liability to pay tax on the income which should have been subjected to deduction of tax by the employer. In every case, the tax deducted by the employer should be added to the employee's income and the gross amount should be taken as the taxable income of the employee.

Proforma of Computing Taxable Salary

Salary
Dearness allowance or Dearness pay
Bonus
Commission
Pension
Employer's contribution in excess 12% to R.P.F.

Interest in excess of 9.5% on Recognised Provident Fund
Taxable Allowances
Taxable portion of partially exempted allowances
Perquisites (after proper valuation)
Taxable part of gratuity
Taxable part of commutation of pension
Lump-sum received from Unrecognised Provident Fund to the extent of Employer's contribution and interest on Provident fund
Taxable part of Compensation received
Gross Salary
<i>Less :</i>	
(i) Entertainment Allowance
(ii) Employment Tax/Professional Tax
Taxable Salary	

ILLUSTRATIONS

Illustration

Calculation of taxable house rent allowance :

Mr. Ram is employed at Bombay. His basic Salary is ₹ 5,000 per month. He receives ₹ 5,000 p.a. as house rent allowance. Rent paid by him is ₹ 12,000 p.a. Find out the amount of taxable house rent allowance.

Solution:

As per Rule 2A, the least of the following is exempt from tax :

- (i) the actual house rent allowance;
 - (ii) excess of rent paid over 10% of salary;
 - (iii) where the accommodation is situate at Bombay, Delhi, Calcutta or Madras, one-half of the amount of salary due to the assessee for the relevant period;
 - (iv) Where the accommodation is situate at any other place, two-fifth of the salary due to the assessee for the relevant period.

Accordingly, Mr. Ram would be entitled to the least of :

- (i) ₹ 5,000 or
 - (ii) ₹ 6,000 being excess of rent over 1/10th of salary; or
 - (iii) ₹ 30,000 (being one-half of the salary of the assessee).

₹ 5,000, being the least, would not be included in the total income of Mr. Ram. So the entire amount of HRA would be exempt from tax.

Salary for this purpose includes basic salary as well as dearness allowance if the terms of employment so provide. It also includes commission based on a fixed percentage of turnover achieved by an employee as per terms of contract of employment but excludes all other allowances and perquisites and these are determined on due basis for the period during which rental accommodation is occupied by the employee in the previous year.

Illustration

Valuation of rent free unfurnished accommodation :

Mr. Shyam, employed at Mumbai, receives the following from his employer during the previous year:

	₹
Basic Salary	60,000
Bonus	1,800
Entertainment allowance (taxable)	6,000
Electricity expenses	2,000
Professional tax paid by the employer	2,000
<i>Rent free house (owned by Employer) :</i>	
Fair rent	48,000
Salary of gardener	2,400
Garden Maintenance	1,200
Salary of watchman	1,800

Determine the value of taxable perquisites in respect of rent free house assuming (a) Mr. Shyam is a Government Officer and the fair rent as arrived at by the Government is ₹ 6,000 p.a (b) Mr. Shyam is a semi-Government employee, and (c) Mr. Shyam is employed by a private company.

Solution:

- (a) *If Mr. Shyam is a Government Officer* : As per Rule 3(1) of Income-tax Rules, ₹ 6,000 p.a being the rent of the house as per Government rules, will be the taxable value of the perquisite.
- (b) *If Mr. Shyam is a semi-Government employee* : As per Rule 3(1) of the Income-tax Rules, the value of the perquisite in respect of rent free accommodation is taken at 15% of salary of the employee (as the house is owned by the Employer and provided in Mumbai).

Salary = ₹ 67,800 (₹ 60,000 + 1,800 + 6,000)

15% of salary = ₹ 10,170 and

Therefore, ₹ 10,170 is taxable value of the perquisite.

Further, the value of Electricity expenses and Professional Tax paid by the employer, being perquisites, are not included in the salary for valuation of Rent Free House Accommodation.

- (c) *If Mr. Shyam is employed in Private Company* : The value of perquisite in this case shall also be ₹ 10,170. Under the new rules there is no difference between the semi-Govt. and other employees.

Illustration

Mr. Ramamoorthy, an employee of M/s. Gopalkrishnan & Co. of Chennai receives during the previous year ended March 31, 2014 the following payments :

	₹
Basic Salary	40,000
Dearness allowance	3,000
Leave Salary	5,400

Professional tax paid by employer	1,000
Fair rent of the flat provided by employer	6,000
Rent paid for furniture	1,000
Rent recovered by employer	3,000
Contribution to Statutory Provident Fund	4,000
Employer's contribution to Statutory Provident Fund	4,000
Compute his taxable income for the Assessment Year 2014-15.	

Solution:

Computation of taxable income of Mr. Ramamoorthy for the Assessment Year 2014-15

	₹
Basic Pay	40,000
Dearness allowance	3,000
Leave salary	5,400
Professional tax paid by employer	1,000
Perquisite for House :	
15% of salary (₹ 40,000 + 3,000 + 5,400)	7,260
Add: Furniture rent	1,000
Less: Rent recovered	<u>(- 3,000)</u>
	<u>5,260</u>
	54,660
Less: Professional tax u/s 16	<u>1,000</u>
Gross Total Income	53,660
Less: Tax deduction under Section 80C	<u>4,000</u>
Tax on total income	<u>49,660</u>
Total tax payable	<u>NIL</u>

Note: Assumed that dearness allowance forms part of the salary for the purpose of computation of superannuation or retirement benefits.

Illustration

Raman, an employee of the Gas Supply Ltd., Agra, receives the following emoluments during the previous year 2013-14.

	₹
Basic pay	10,000
Project allowance	1,800
Arrears of project allowance of May, 1983	150
Professional tax paid by the employer	200
Rent free furnished house	

– Fair rent of the house	2,000
– Rent of furniture	500
Free gas supply	400
Service of sweeper	600
Services of gardener	1,000
Service of cook	800
Free lunch	2,400

Free use of chauffeur driven Fiat car which is used partly for official and partly for private purposes.

He is a member of recognised provident fund to which he contributes ₹ 1,500. His employer also contributes an equal amount. He deposits ₹ 600 per month in 10 year account under the Post Office Savings Bank (CTD) Rules. Determine his taxable income and tax payable thereon for the assessment year 2014-15. (a) If Raman is a director in the employer company and the rent-free house is owned by it, (b) If Raman is neither a director nor a shareholder in the employer company and the rent-free house is not owned by it.

Solution:

His taxable income will be computed as under :

	If Raman is a director and rent-free house is owned by the company not owned by the Company 'A'	If Raman is neither a director nor a shareholder and rent-free house is 'B'
	(1)	(2)
	₹	₹
Basic Pay	10,000	10,000
Project allowance	1,800	1,800
Arrears of project allowance of May, 1983	150	150
Professional tax paid by the employer	200	200
Rent free furnished house :		
— 15% of Salary	1,770	1,770
— Rent of furniture	500	500
Free gas supply	400	Nil
Service of sweeper	600	Nil
Service of gardener	1,000	Nil
Service of cook	800	Nil
Free lunch	Nil	Nil

Excess of employer's contribution towards provident fund over 12% of salary (1,500 - 12% of ₹ 10,000)	<u>300</u>	<u>300</u>
Gross salary	18,110	15,310
Net Income from Salary:	<u>18,110</u>	<u>15,310</u>
Tax on total income	Nil	Nil

Notes :

- (1) It is assumed that the arrears of project allowance are taxable on receipt basis.
- (2) Perquisite in respect of Rent Free house is taxable in the hands of all the assessees. In this case fair market value has no relevancy (w.e.f. AY 2002-03) and assumed that the house is owned by the employer. Since the house is provided in Agra, population is assumed as exceeding ₹ 25 lakhs. Salary for valuation of perquisite is (₹ 10,000 + ₹ 1,800).
- (3) The free sweeper, gardener, cook, lunch, car etc. are not taxable in the second case, because Raman does not fall in the category of specified employee under Section 17(2)(iii) of the Act i.e., he is neither a director nor his salary is ₹ 50,000 p.a. or more.
- (4) Free lunch provided is not taxable to the extent of ₹ 50 per day.
- (5) Since Raman is employed in a Gas supply company, the value of gas supplied is taxable as cost to the employer. And it is assumed that the cost of supply is same as ₹ 400 as given.

Illustration

For the year ended 31.3.2014, B receives a salary of ₹ 91,000 and conveyance allowance of ₹ 24,000. He is also provided with accommodation at Mumbai at concessional rent. The monthly rent of the accommodation is ₹ 7,500 of which ₹ 5,000 is paid by the employer. The balance of ₹ 2,500 is paid by B. B's contribution to employee's provident fund account is ₹7,592 and he pays ₹10,298 as life insurance premia. His expense on conveyance for official purposes was ₹22,500 for the year. Compute B's tax liability for the assessment year 2014-15 assuming that he has no other income.

Solution:

Assessment year : 2014-15

Name of Assessee : Mr. B

Statement of Total income

	₹	₹
Basic Salary	91,000	
Conveyance allowance	24,000	
Less : Amount exempt under Section 10(14)		
(800 x 12)	<u>9,600</u>	14,400
Perquisite value of accommodation provided at concessional rent		<u>Nil</u>

Gross Salary	<u>1,05,400</u>
Net Income from Salary	1,05,400
Less : Deduction under Section 80C (7,592 + 10,298)	<u>17,890</u>
Total Income	<u>87,510</u>
Tax liability	Nil

Note: Salary for the purpose of calculation of perquisite value of accommodation provided at concessional rent is ₹ (91,000 + 14,400) = ₹ 1,05,400. The value of the house perquisites shall be:

15% of salary	15,810
Less: Rent actually paid by B	<u>30,000</u>
Perquisite value	<u>Nil</u>

Illustration

For the financial year 2013-14, 'A', a Central Government Officer receives salary of ₹ 77,000 (including dearness allowance of ₹ 42,000) and entertainment allowance of ₹ 18,000. His contribution to provident fund during this period is ₹ 7,200. In addition, he has purchased National Savings Certificates (VIII Issue) for ₹ 6,000. He has been provided with accommodation by the Government for which the rent determined is ₹ 375 per month and this is recovered from A's salary. Compute A's tax liability for the assessment year 2014-15 assuming that he has no other income.

Solution:

Name of assessee : Mr. A

Assessment Year : 2014-15

Status : Resident/Individual

Statement of assessable income

	₹	₹
Salary from Central Government	77,000	
Entertainment allowance	18,000	95,000
Less: Entertainment Allowance under Section 16(ii) ₹ 5,000 or [1/5th of salary exclusive of any allowance, benefit or perquisite (₹ 35,000)]	<u>5,000</u>	<u>(-) 13,000</u>
GROSS TOTAL INCOME		82,000
Less : Deduction under Section 80C (7,200 + 6,000)		<u>13,200</u>
Total Income		<u>68,800</u>
Tax liability		Nil
Net tax payable		Nil

Illustration

Mr. A, the General Manager of XYZ Ltd., retired on 31.12.2013 after 30 years of service.

The particulars of his income are as follows:

1. Salary ₹ 10,000 per month from January 1, 2013. House rent allowance ₹ 4,000 per month from January 1, 2013.
2. Medical expenses reimbursed by employer: ₹ 7,200 for the period from April 1, 2013 to December 31, 2013.
3. Mr. A and his family also availed LTC - they visited Mumbai and the expenses of ₹ 5,600 being the cost of air conditioned second class rail tickets was reimbursed by the employer.
4. The employer provides him a car for personal purposes and expenses are incurred by the employer amounting to ₹ 9,900.
5. Mr. A contributes 22% (12% regular and 10% additional voluntary contribution) to recognised provident fund and the company matches his regular contribution of 12%.
6. Mr. A has invested ₹ 20,000 in ULIP Scheme of UTI and ₹ 10,000 in public provident fund. He paid ₹ 8,000 towards life insurance premium on policy for a sum assured of ₹ 60,000.
7. He lives in his own house. The annual municipal value of the house is ₹ 15,000.
8. Payment of club bills to the extent of ₹ 2,700 for the year being monthly subscription @ 300 per month was reimbursed by the employer.
9. Mr. A received ₹ 1,50,000 as gratuity. He is not covered by the Payment of Gratuity Act.
10. He received ₹ 1,60,000 for encashment of leave, being 16 months' leave not availed of.

Compute A's income for the assessment year 2014-15.

Solution:

Name of the assessee : Mr. A

Assessment year : 2014-15

Computation of taxable income

	₹
(a) Salary (10,000 x 9)	90,000
HRA (4,000 x 9)	36,000
Payment of club bills (300 x 9)	2,700
Gratuity (See note 7)	—
Car facility	9,900
Encashment of leave (1,60,000 – 1,00,000)	
(See note 8)	<u>60,000</u>
Gross salary income	1,98,600
Net salary income	1,98,600
(b) Income from house property (one self occupied house)	

[wholly exempt under Section 23]	<u>NIL</u>
Gross Total income	1,98,600
Less: Deduction under Section 80C	—
Less:	
Qualifying Amount (QA) for deduction under Section 80C of the Act:	
PF contribution	19,800
ULIP purchased	20,000
Contribution in PPF	10,000
Life Insurance premium	<u>8,000</u>
Qualifying Amount:	<u>57,800</u>
Total Income	<u>1,40,800</u>
Tax payable	0
Add: Education cess @ 2%	<u>0</u>
Tax liability of Mr. A for assessment year 2014-15	<u>0</u>

Notes:

1. HRA is fully taxable as X lives in his own house.
2. Medical expenses reimbursed are not chargeable to tax to the extent of ₹15,000.
3. Reimbursement of rail fare (air conditioned second class) is exempt under Section 10(5) of the Act. Further, it is presumed that other conditions as laid down in Rule 2B of Income-tax Rules, 1962 are also satisfied.
4. Life insurance premium qualifies for deduction under Section 80C.
5. Notional income from one self occupied house is not chargeable to tax. Deduction of municipal taxes, insurance premium etc. in respect of such house is also not allowed.
6. Club bills are taxable unless the membership is primarily for the benefit of the employer. It is presumed in this case that it is not so.
7. Gratuity is exempt to the least of the following:
 - (i) $\frac{1}{2}$ month's salary for every completed year of service (calculated on the basis of average salary for 10 months preceding the retirement), $10,000 \times \frac{1}{2} \times 30 = 1,50,000$.
 - (ii) ₹ 10,00,000.
 - (iii) Actual gratuity received ₹1,50,000.
8. Leave salary is exempt to the extent of the least of the following:
 - (i) Salary in respect of unavailed leave at the time of retirement 1,60,000
 - (ii) Salary for 10 months 1,00,000
 - (iii) Limit of exemption as specified by the Government 3,00,000
 - (iv) Leave encashment actually received at the time of retirement 1,60,000

Exemption is limited to ₹1,00,000 being the least of the amounts mentioned above.

Illustration

'A' furnishes the following details of his salary income for the financial year 2013-14:

	₹
(1) Salary	4,000 p.m.
(2) Dearness Allowance	500 p.m.
(3) Entertainment Allowance	200 p.m.
(4) Employer's and his own contribution to unrecognised Provident Fund	2,600 each
(5) Interest on the accumulated balance of provident fund @ 12% p.a.	2,600
(6) City Compensatory Allowance	60 p.m.
(7) Medical Allowance	1,500 p.a.
(8) Project Allowance	600 p.m.
(9) He is also provided with an unfurnished accommodation for which his employer charges ₹ 200 p.m. The fair rent of house is ₹ 12,000 per annum. The house is owned by the employer.	

Compute his taxable income from salary for the assessment year 2014-15.

Solution:**Computation of taxable income of Mr. A from salary for the assessment year 2014-15**

	₹
Salary (₹ 4,000 x 12)	48,000
Dearness allowance (₹ 500 x 12)	6,000
Entertainment allowance (₹ 200 x 12)	2,400
City Compensatory allowance (₹ 60 x 12)	720
Medical allowance	1,500
Project Allowance	7,200
Perquisite value of accommodation provided at concessional rent	<u>6,573</u>
Gross Salary	<u>72,393</u>
Net Income from Salary	<u>72,393</u>

Notes:

1. Employer's and Mr. A's own contribution to unrecognised Provident Fund and interest thereon is exempt from tax during the normal course of employment.
2. Fixed medical allowance is taxable.
3. Due to absence of any specific information about Mr. A's residence, he has been treated as a resident of any place having population exceeding 25 lakhs.
4. Salary for the purpose of calculation of perquisite value of accommodation provided at concessional rent is ₹ (48,000 + 2,400 + 720 + 1,500 + 7,200) = ₹ 59,820. It is assumed that the house is owned by the employer. The value of house perquisite shall be .

₹	
15% of Salary	8,973
Less: Rent actually paid by B	<u>2,400</u>
Perquisite value	6,573

Illustration

Compute taxable salary income of Mr. Z of Kanpur for the assessment year 2014-15 based on the following information:

₹	
– Salary @ ₹ 4,000 p.m. (serving since 1.4.1997)	48,000
– Entertainment Allowance	5,000
– Bonus	10,000
– Dearness Allowance (not recognised for computing retirement benefit)	2,000
– Employer's contribution to provident fund (recognised)	4,000
– Education Allowance for one child	2,700
– Lunch Allowance	7,200
– Rent-free unfurnished quarters (valued)	6,000
– Medical expenses met by employer	600
– Reimbursement of hotel bills (necessary for duty)	100
– Employee's contribution to Provident Fund	2,000
– Premium of Mrs. Z's life policy of ₹ 50,000	6,000
– Purchase of books necessary for duty	1,000
– Share of HUF	50,000

Solution:**Computation of Salary Income of Mr. Z for the assessment year 2014-15**

Particulars	Amount (₹)
– Salary (i.e. ₹ 4,000 x 12)	48,000
– Entertainment Allowance	5,000
– Bonus	10,000
– Dearness Allowance	2,000
– Employer's contribution to recognised provident fund (since it is not exceeding 12% of salary)	Exempt
– Education allowance for one child	2,700
<i>Less: Exempt under Section 10(14):</i>	
(1 x 100 x 12)	(1,200)
	1,500

– Lunch Allowance	7,200
– Valuation of rent free unfurnished quarters (value as given, because it being less than 20% of salary)	6,000
– Medical expenses met by employer	Exempt
– Reimbursement of hotel bills (necessary for duty)	<u>Exempt</u>
Gross Salary	79,700
Net Salary	<u>79,700</u>

Qualifying Amount for deduction under Section 80C of the Act:

(i) Mr. Z's contribution to recognised provident fund	2,000
(ii) Premium of Mrs. Z's life policy	<u>6,000</u>
	<u>8,000</u>

Notes:

- (1) Entertainment allowance is not exempt as per provisions of Section 16(ii) of the Act.
- (2) Children Education allowance is exempt @ ₹ 100 per month per child upto maximum of two children as per provisions of Section 10(14) of the Act.
- (3) Value of rent free unfurnished quarters shall be 15% of salary, assuming that the house is not owned by the employer. Salary for this purpose is ₹ 71,700 (i.e. ₹ 48,000 + 5,000 + 10,000 + 7,200 + 1500).
 - 15% of Salary ₹ 10,755
 - Value of quarters ₹ 6,000

Value of perquisite shall be lesser of above two (i.e. ₹ 6,000).

- (4) Share from HUF is not taxable under section 10.

DIFFERENT MEANINGS OF 'SALARY' FOR DIFFERENT PURPOSES

<i>For computation of taxable income under the head salaries</i>	<i>Rent-free House or Concession in rent</i>	<i>House Rent Allowance</i>	<i>Qualifying Amount of Contribution to R.P.F.</i>	<i>Entertainment Allowance</i>	<i>Gratuity</i>	<i>Determination of ₹50,000 regarding taxability of perquisites u/s 17(2)(iii)(c)</i>	<i>Compensation u/s 10(10B)</i>
1. Basic salary or wages. 2. Advance salary. 3. Arrears of salary. 4. Annuity or pension. 5. Gratuity. 6. Fees, Commission, Bonus. 7. Allowances	1. Basic Salary (excluding advance or arrear of salary received). 2. Taxable Allowances. 3. Bonus. 4. Commission or, 5. Any monetary	1. Basic Salary. 2. Dearness Allowance if the terms of employment so provide, i.e. it is taken into account for retirement benefits, or Dearness	Same as for house Rent Allowance as per preceding column.	Basic Salary exclusive of any allowance, benefit or other perquisite.	Basic Salary, D.A. (if given under the terms of employment) and Commission based on fixed percentage of turnover. It does not include	Basic Salary, Dearness Allowance, All other taxable allowances, benefits received in cash, Bonus, Commission, etc. and all monetary payments included in gross salary	Salary, allowance, value of rent-free or concessional accommodation light, water or any other amenity and travel concession; but does not include Bonus, Gratuity

including Dearness Allowance. 8. Profits in lieu of salary. 9. Perquisites. 10. Excess contribution to R.P.F. by employer over 12% of salary. 11. Excess interest received from R.P.F. over 9.5% rate of interest will be taxable. 12. Taxable portion of transferred balance to R.P.F.	payment (Excluding dearness allowance not entering into retirement benefits of the employee, employer's contribution to R.P.F. allowances exempt from tax, deductible amount of value of perquisites).	Pay. (Excluding all other allowances, bonus or perquisites and all extras). 3. Commission based on fixed percentage of turnover achieved by the employee and given under terms of employment.			bonus, other commission, H.R.A. overtime wages and any other allowance and perquisites. If the employee is covered by the Gratuity Act, D.A. will always be included in salary.	after allowing deductions u/s 16. For this purpose salary will not include perquisites not received in cash.	employer's contribution to any fund for retirement benefits.
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LESSON ROUND UP

- **Basis of Charge:** As per section 15, salary is taxable on due or receipt basis whichever is earlier. Under Section 15 the income chargeable to income tax under the head salaries would include any salary due to an employee from an employer or a former employer during the previous year irrespective of the fact whether it is paid or not.
- **Different forms of salary:**
 - (A) **Basic Salary:** Basic salary is taxable in the hands of an employee.
 - (B) **Allowance:** An allowance is defined as a fixed amount of money given periodically in addition to the salary for the purpose of meeting some specific requirements connected with the service rendered by the employee or by way of compensation for some unusual conditions of employment. It is taxable on due/accrued basis whether it is paid in addition to the salary or in lieu thereon.
 - (C) **Perquisites:** The term “perquisites” includes all benefits and amenities provided by the employer to the employee in addition to salary and wages either in cash or in kind which are convertible into money. These benefits or amenities may be provided either voluntarily or under service contract. For income-tax purposes, the perquisites are of three types:
 - Tax-free perquisites
 - Taxable perquisites
 - Perquisites taxable under specified cases.

Valuation of perquisites: The basic principles governing valuation of perquisites are as follows :

- The valuation is done on the basis of their value to the employee and not the employer's cost for providing the same - Wilkins v. Rogerson (1963) 49 ITR 395 (CA).

- The value of perquisite is included in the salary income only if the perquisite is actually provided to the employee.
- Perquisite which is not actually enjoyed by the employee (though the terms of employment provide for the same) cannot be valued and taxed in the employee's hands. Therefore, where the employee waives his right of perquisite, he cannot be taxed thereon.
- **Allowable deductions under the head Salaries:** The following amounts shall be deducted in order to arrive at the chargeable income under the head 'Salaries'.
 - (A) Standard deduction: Omitted
 - (B) Entertainment allowance
 - (C) Tax on employment or Professional Tax
- Provident Funds are grouped under these heads –
 - (a) Statutory provident fund.
 - (b) Recognised provident fund
 - (c) Unrecognised provident fund

SELF TEST QUESTIONS

These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation.

MULTIPLE CHOICE QUESTIONS

1. Which of the following income is taxable under the head 'income from salary' –

- (a) Salary received by a partner from firm
- (b) Salary received by a Member of Parliament
- (c) Salary of a Government Officer
- (d) None of the above.

..... ₹600 per month from a private company. He gets three-fifth of the pension commuted and received ₹36,000. He did not receive gratuity. The taxable portion of commuted value of pension is –

- (a) ₹16,000
- (b) ₹6,000
- (c) ₹18,000
- (d) ₹12,000.

3. Sneha is an employee in a private company. In the previous year she received salary ₹1,80,000 and entertainment allowance ₹12,000. She spent ₹6,000 on entertainment. Under section 16(ii), she is entitled to deduction of –

- (a) ₹12,000
- (b) ₹6,000
- (c) ₹5,000
- (d) Nil.

4. Interest-free loan to an employee, where the amount of loan does not exceed any one of the following, shall be treated as the tax-free perquisite in all cases under section 17(2) –

- (a) ₹10,000
- (b) ₹15,000
- (c) ₹20,000
- (d) ₹25,000.

5. Prakash obtained interest-free loan of ₹20,000 from his employer company for purchasing a two-wheeler. The market rate of interest on such loan is 20% per annum. The lending rate of State Bank of India is 15.5% and that of the private sector banks is 16%. The taxable amount of this perquisite will be computed at the rate of –

- (a) 20%
- (b) 16%
- (c) 15.5%
- (d) Nil rate.

6. The maximum exemption in respect of transport allowance granted to an employee to meet his expenditure for the purpose of commuting between the place of his residence and the place of his duty shall be –

- (a) ₹ 600 per month
- (b) ₹ 700 per month
- (c) ₹ 800 per month
- (d) ₹ 900 per month

TRUE AND FALSE

1. Remuneration received by Member of Parliament are taxable under the head “Income from other sources”.
2. No deduction is allowable from income from salary.
3. Allowances payable to Central Government employees for serving outside India is fully taxable as salary.
4. Telephone provided to an employee at his residence is a tax-free perquisite.

SHORT NOTES

1. Profit in lieu of salary
2. Entertainment Allowance
3. Leave Travel Concession

DISTINGUISH BETWEEN

1. Statutory provident fund’ and ‘public provident fund’.
2. House Rent Allowance and Rent Free Accommodation.
3. Allowances and Perquisites.

PRACTICAL QUESTIONS

1. Savita submits the following information regarding her salary income :

Basic salary ... ₹11,000 per month

City compensatory allowance ... ₹150 per month

Children education allowance ... ₹400 per month (for 3 children)

Reimbursement of medical expenses ... ₹25,000

She was entitled to house rent allowance of ₹6,000 per month from 1st April, 2013 to 31st August, 2013. However, she was paying a rent of ₹7,000 per month for a house in New Delhi. With effect from 1st September, 2013, she was provided with an accommodation by the company for which the company was paying a rent of ₹5,000 per month.

Compute her gross salary for the assessment year 2014-15.

2. Atul is working as Accounts Officer with Badri Steels Ltd., Ghaziabad drawing a salary of ₹40,000 per month. He gets D.A. @ 12% of salary and entertainment allowance @ ₹800 per month. He spends 40% of entertainment allowance on entertaining the customers of the company. The company has provided him the facility of rent-free unfurnished house for which the company pays rent @ ₹3,000 per month. The company has provided the services of a cook at the house of Atul for which the company pays ₹1,000 per month as salary. The facility of free refreshment and free meal for 300 days is provided to Atul costing ₹25 per day and ₹120 per day respectively during working hours in the office.

Atul and the company both contribute 15% of basic pay and D.A. towards recognised provident fund; ₹10,000 is credited to provident fund account by way of interest @ 9% per annum. Compute taxable income from salary of Atul for the assessment year 2014-15.

ANSWERS/HINTS

Multiple choice question

1. (c); 2. (b); 3. (d); 4. (c); 5. (d); 6. (c)

True and False

1 True; 2 False; 3 False; 4 True;

Practical questions

1. ₹1,60,618; 2. ₹6,39,825

SUGGESTED READINGS

- | | | |
|--------------------------------|---|---|
| 1. Dr. V.K. Singhania | : | Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi. |
| 2. Girish Ahuja and Ravi Gupta | : | Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi. |

Lesson 4

Part II – Income under the head House Property

LESSON OUTLINE

- Basis of Charge
- Deemed ownership
- Determination of Annual Value
- Computation of Net Annual Value
- Properties Let Out [Section 23(1)]
- Properties occupied by the owner [Section 23(2)]
- Houses which are partly let out and partly self-occupied
- Properties owned by Co-owners (Section 26)
- Deductions from Income from House Property (Section 24)
- Amount not deductible from income from house property (Section 25)
- Special provisions for cases where unrealised rent allowed as deduction is realised subsequently (Section 25A)
- Loss from House Property
- Illustrations
- Exemptions
- Lesson Round Up
- Self Test Question

LEARNING OBJECTIVES

The provisions for computation of Income from house property are covered under sections 22 to 27. This chapter deals with the provisions for computation of Income from house property. Section 22 is the charging section that identifies the basis of charge wherein the annual value is prescribed as the basis for computation of Income from House Property. Therefore, the process of computation of “Income from House Property” starts with the determination of annual value of the property. The concept of annual value and the method of determination are laid down in section 23. The admissible deductions available from house property are mentioned in section 24.

At the end of this lesson, you will learn the conditions to be satisfied for income to be chargeable under this head, how to determine the annual value of different type of house properties, admissible deductions and inadmissible deductions from annual value, tax treatment of unrealized rent, who are deemed owners, what is meant by co-ownership and what is its tax treatment etc.

Income from house property is one of the important heads of income under the Income Tax Act. The tax payers have been, in particular, keen to know about the exemptions and deductions available to them on repayment of interest and principal of the loan obtained to purchase the house property, if that house property is let out or self-occupied. The amount of interest on borrowed capital of the current year is available under the head house property further repayment of principal is available under section 80C to individuals and Hindu Undivided Families.

BASIS OF CHARGE

Section 22 of the Act provides as follows:

"The annual value of property consisting of any buildings or lands appurtenant thereto of which the assessee is the owner, other than such portions of such property as he may occupy for the purposes of any business or profession carried on by him, the profits of which are chargeable to income-tax, shall be chargeable to income-tax under the head Income from House Property".

The following points emerge from the above charging section:

(a) *Tax is charged on income from the buildings or lands appurtenant thereto:*

The buildings include residential buildings, buildings let out for business or profession or auditoriums for entertainment programmes. The location of the building is immaterial. It may be situated in India or abroad.

(b) *Tax is charged on income from lands appurtenant to buildings :*

Where the land is not appurtenant to a building the income from land can be charged as business income or "income from other sources", as the case may be. The lands appurtenant to buildings include approach roads to and from public streets, courtyards, motor garage, compound, play-ground and kitchen garden. In case of non-residential buildings, car-parking spaces, drying grounds or play-grounds shall be the lands appurtenant to buildings.

(c) *Tax is charged from the owner of the buildings and land appurtenant thereto:*

Where the recipient of the income from house property is not the owner of the building, the income is not chargeable under this head but under the head 'Income from Business or Other Sources'. For example, the income to a lessee from sub-letting a house or income to a mortgagee from house property mortgaged to him is not chargeable under the head 'Income from House Property'.

The owner of the buildings may be the legal owner or beneficial owner. In ownership, the ownership of building is considered and not the ownership of income. In certain cases the income may not be received by the owner of the building, still he shall be liable to tax because he is the owner of the building.

Deemed ownership

As per section 27, the following persons though not the legal owners of a property are deemed to be the owners for the purposes of sections 22 to 26:

(i) Transfer to a spouse or minor child:

an individual who transfers otherwise than for adequate consideration any house property to his or her spouse, not being a transfer in connection with an agreement to live apart, or to a minor child not being a married daughter;

(ii) Holder of an imitable estate:

the holder of an imitable estate as the individual owner of all the properties comprised in the estate;

(iii) Member of a co-operative society:

a member of a co-operative society, company or other association of persons to whom a building or part thereof is allotted or leased under a house building scheme of the society, company or association, as the case may be, of that building or part thereof;

(iv) Person in possession of a property:

a person who is allowed to take or retain possession of any building or part thereof in part performance of a contract of the nature referred to in Section 53A of the Transfer of Property Act, 1882;

(v) Person having right in a property for a period not less than 12 years:

with effect from assessment year 1988-89, a person who acquires any rights (excluding any rights by way of a lease from month to month or for a period not exceeding one year) in or with respect to any building or part thereof, by virtue of any such transaction as is referred to in clause (f) of Section 269UA, of that building or part thereof.

Note that :

- (1) *If a firm transfers its house property to its partners, before dissolution, merely by book entries, annual value of the property is taxable in the hands of the firm – Inder Narain Har Narain v. C.I.T. (1980) 3 Taxman 365 (Delhi).*
- (2) *Where a Muslim transfers a property of a value of more than ₹ 100 it must be by registered instrument and not orally. This is the position even with respect to a property purporting to have been orally given over by a Muslim husband to his wife in the discharge of his dower debt to her. Accordingly, the income from a property thus given will be included in the total income of the husband only – Syed Sadique Iman v. C.I.T. (1979) 117 ITR 62 (Patna).*
- (3) *In the case of tenant co-partnership co-operative housing societies, the income from each building should be assessed in the hands of the individual members to whom it has been allotted. Conversely, for all purposes (including attachment and recovery of tax, etc.) the individual members should be regarded as the legal owners of the property in question.*
- (4) *Also, for the purposes of Section 22, the custodian should be treated as owner of an evacuee's property from the date of its vesting in him.*

And, in respect of all properties of an evacuee vested in him, an assessment should be made upon the custodian, but in respect of properties vested in him, and belonging to different evacuees, separate assessments in respect of each evacuee should be made upon him.

The relevant status as to residence for the purposes of such assessments, is that of the assessee-custodian and that is resident and ordinarily resident.

The rates of income-tax applicable in any such assessment are those appropriate to the total income of a "resident individual".

Other points with regard to ownership

- (i) **Official assignee or receiver :** Where the owner of the property becomes insolvent, the official assignee or receiver under the law of insolvency shall be chargeable in respect of the income from such house property as the owner. However, the receiver appointed by the Court shall not be deemed to be the owner of the insolvent's property, because the property does not vest in him.
- (ii) **Ownership in dispute :** Where the title to the property is in dispute, the Assessing Officer is empowered to decide the ownership of the property for income-tax purposes. However, where the decision of the Court is contrary to the Assessing Officer's decision, the decision of the court will prevail and he will reassess the assessee accordingly.
- (iii) **Co-owners of the property :** Where the property is owned jointly by two or more persons and their respective shares are definite and ascertainable, they shall be assessed individually on their shares in the income from the property (Section 26).
- (iv) **Owner in the previous year :** Since tax is levied only on the income of previous year, annual value of

property owned by a person during the previous year, is taxable in the following assessment year, even if the assessee is not the owner of the property during the assessment year.

- (v) Status of property in a foreign country :** A resident assessee is taxable under Section 22 in respect of annual value of a property situated in a foreign country.

But, a resident but not ordinarily resident or non-resident is chargeable under Section 22 in respect of income of a house property situated abroad, only if income is received in India during the previous year. In such cases where tax incidence is attracted, the annual value is computed as if the property is situated in India.

(d) Utilised by the assessee for his own business or profession purpose

The annual value of such property or the portion thereof as is utilised by the assessee for the purposes of his own business, profession or vocation, the profits of which are assessable to tax, is not taxable under Section 22. The assessee is also not allowed to claim any deduction in respect of notional rent while computing income from any such business, profession or vocation. However, the assessee can claim depreciation under Section 32 of the Income-tax Act and also, he can claim other expenses e.g. repairs, insurance, municipal taxes, interest on borrowed capital etc. for such business income.

(e) Taxability of rental income from a owned house property

Rents or income arising from ownership of any house property cannot be taxed under any other head since Section 22 provides a specific head for charge of such income to tax. In the case of *Commercial Properties Ltd. v. C.I.T.* 3 ITC 23, the assessee company had the sole object of acquiring lands, building houses and letting the premises to tenants. It was held that the income from property was taxable under Section 22 and not under Section 28, i.e., profits and gains of business or profession. However, where the subject which is let is not a mere tenement, but is a complex one, e.g., a well-equipped theatre, safe deposits vaults, or vaults for storing or preserving films, including special devices, facilities and services or a well-furnished paying guest establishment - the income cannot be said to be derived from mere ownership of house property but may be assessable as income from business [*C.I.T. v. National Storage (P) Ltd.* (1967) 66 ITR 596 (SC)].

Similarly, the following income from buildings is not assessable under this head:

- (a) **Buildings or staff quarters let out to employees and others:** Where the assessee lets out the building or staff quarters to the employees of business whose residence there is necessary for the efficient conduct of business, the rent collected from such employees is assessable as income from business and taxable under the head business or profession and not under this head. [*CIT v. Delhi Cloth & General Mills Co. Ltd.* (1966) 59 ITR p.152 (Punjab)].
- (b) **If building is let out to authorities for locating bank, post office, police station, central excise office, etc.:** income will be assessable as income from business provided the dominant purpose of letting out the building is to enable the assessee to carry on his business more efficiently and smoothly. [*CIT v. National Newsprint and Paper Mills Ltd.* (1978) 114 ITR 388 (MP)].
- (c) **Composite letting of building with other assets:** Where the assessee lets on hire machinery, plant or furniture belonging to him and also buildings and the letting of the buildings is inseparable from the letting of the said machinery, plant or furniture, the income from such letting is chargeable to tax under the head "Income from other Sources" if it is not chargeable to income-tax under the head "Profits and gains of business or profession" [Section56(2)(iii)].

However, if rent is separable between rent of building and rent for other facilities viz. rent of machinery, plant or furniture or other facilities etc, then rent of building would be taxable as Income from house property and rent for machinery, plant or furniture or other facilities would be taxable as either Income from Other Sources or Profits and gains of business or profession, depending upon the facts of each case.

- (d) **Income of State Industrial Development Corporation for letting out of sheds, etc.** is business income and is not taxable under Section 22 – *CIT v. A.P. Small Scale Industrial Development Corp. (1989) 175 ITR 352 (AP)*.
- (e) **Services rendered in providing electricity, use of lifts, supply of water, maintenance** of stair case and watch and ward facilities are not incidental to letting out property, and charges qua said services are assessable as income from other sources, and not under Section 22 (as income from house property) - *CIT v. Model Mfg. Co. (P) Ltd. (1989) 175 ITR 374 (Cal.)*.

DETERMINATION OF ANNUAL VALUE U/S 23

The measure of charging income-tax under this head is the annual value of the property, i.e., the inherent capacity of a building to yield income. The expression 'annual value' has been defined in Section 23(1) of the Income-tax Act as:

- (1) For the purposes of Section 22, the annual value of any property shall be deemed to be:
 - (a) the sum for which the property might reasonably be expected to let from year to year; or
 - (b) where the property or any part of the property is let and the actual rent received or receivable by the owner in respect thereof is in excess of the sum referred to in clause (a), the amount so received or receivable; or
 - (c) where the property or any part of the property is let and was vacant during the whole or any part of the previous year and owing to such vacancy the actual rent received or receivable by the owner in respect thereof is less than the sum referred to in clause (a), the amount so received or receivable.

Provided that the taxes levied by any local authority in respect of the property shall be deducted (irrespective of the previous year in which the liability to pay such taxes was incurred by the owner according to the method of accounting regularly employed by him) in determining the annual value of the property of that previous year in which such taxes are actually paid by him, i.e., municipal taxes will be allowed only in the year in which it was paid.

Explanation : For the purposes of clause (b) or clause (c) of this sub-section, the amount of actual rent received or receivable by the owner shall not include, subject to such rules as may be made in this behalf, the amount of rent which the owner cannot realise.

- (2) Where the property consists of a house or part of a house which:
 - (a) is in the occupation of the owner for the purposes of his own residence; or
 - (b) cannot actually be occupied by the owner by reason of the fact that owing to his employment, business or profession carried on at any other place, he has to reside at that other place in a building not belonging to him, the annual value of such house or part of the house shall be taken to be nil.
- (3) The provisions of Sub-section (2) shall not apply if:
 - (a) the house or part of the house is actually let during the whole or any part of the previous year; or
 - (b) any other benefit therefrom is derived by the owner.
- (4) Where the property referred to in Sub-section (2) consists of more than one house:
 - (a) the provisions of that sub-section shall apply only in respect of one of such houses, which the assessee may, at his option, specify in this behalf;
 - (b) the annual value of the house or houses, other than the house in respect of which the assessee has exercised an option under clause (a), shall be determined under Sub-section (1) as if such house or houses had been let.

Rules made in this behalf - Notification No. 198/2001 dated 2-7-2001

The amount of rent which the owner cannot realise shall be equal to the amount of rent payable but not paid by a tenant of the assessee and so proved to be lost and irrevocable only if following conditions are satisfied:

- (a) tenancy is bonafide;
- (b) the defaulting tenant has vacated, or steps have been taken to compel him to vacate the property;
- (c) the defaulting tenant is not in occupation of any other property of the assessee;
- (d) the assessee has taken all reasonable steps to institute legal proceedings for the recovery of the unpaid rent or satisfied the Assessing Officer that legal proceedings would be useless.

COMPUTATION OF ANNUAL VALUE/NET ANNUAL VALUE

Net annual value shall be computed in the following manner:

1. Determine the Gross Annual Value
2. Deduct municipal tax actually paid by the owner during the previous year from the Gross Annual Value.

For the purpose of computation of net annual value, properties can be classified into three categories :

- (A) Properties let out throughout the year.
- (B) Properties occupied by the owner for residential purposes or properties not self-occupied owing to employment at any other place.
- (C) Partly let out and partly self occupied property.

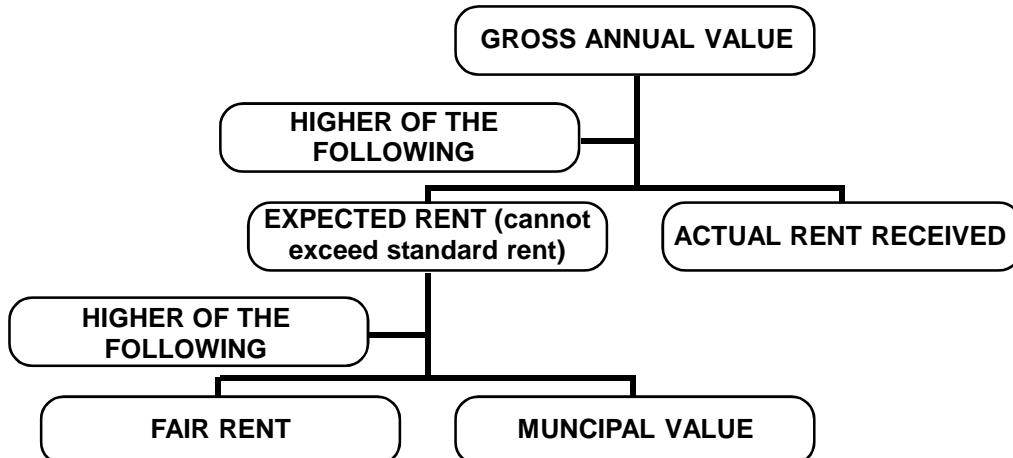
A. Properties let-out [Section 23(1)]

Gross annual value shall be higher of

- (a) Expected Rent
- (b) Actual rent received or receivable.

The higher of Municipal value and fair rental value shall be **Expected rent**. Therefore, from these Judgments, it is evident that expected rent shall not exceed the Standard rent.

However, the Supreme Court in *Shiela Kaushish v. CIT* (1981) 131 ITR 435 (SC) and *Amolak Ram Khosla v. CIT* (1981) 131 ITR 589 (SC) held that where property let out is governed by the Rent Control Acts, the standard rent fixed or applicable to the area of property, will have to be taken for determining the annual value. Also, it was held in the case of *Balbir Singh (Dr.) v. MCD* (1985) 152 ITR 388 (SC) that although the expected rent cannot exceed standard rent but it can be lower than standard rent.



Municipal Value: Municipal value is the value determined by the municipal authorities for levying municipal taxes on house property.

Fair rent: Fair rent is the amount which a similar property can fetch in the same or similar locality, if it is let for a year.

Standard Rent: The standard rent is fixed under Rent Control Act. In such a case, the property can not be let for a amount which is higher than the standard rent fixed under the Rent Control Act.

Actual rent received or receivable: Actual rent is rent for let out period. It is the *de facto* rent (i.e. what should have been the actual rent). For example, if water and electricity bills of tenant are payable by the owner, then *de facto* rent will be calculated by reducing from the rent received/receivable the amount spent by the owner for those bills. On the other hand, for example, if any obligation of water and electricity bills is met by the tenant, then amount spent by the tenant will be included for the purpose of calculating actual rent received/receivable or *de-facto* rent. Municipal taxes are to be borne by the occupier who in the case of let out property is the tenant. Therefore, if such municipal taxes are borne by the tenant, the rent received/receivable should not be increased to calculate the *de-facto* rent.

While computing the net annual value the following deduction are made from the gross annual value :

Municipal Taxes : The taxes including service taxes (fire tax, conservancy tax, education, water tax, etc.) levied by any municipality or local authority in respect of any house property to the extent to which such taxes are borne and paid by the owner, and include enhanced municipal tax finally determined on appeal and payable by assessee - *Clive Buildings Cola Ltd. v. CIT* (1989) 44 Taxman 160.

However, deduction in respect of municipal taxes will be allowed in determining the annual value of the property only in the year in which municipal taxes are actually paid by the owner.

Where the tax on property is enhanced with retrospective effect by municipal or local authorities and the enhanced tax relating to the prior year is demanded during the assessment year, the entire demand is deductible in the assessment year [*C.I.T. v. L. Kuppu Swamy Chettiar* (1981) 132 ITR 416 (Mad.)].

Even where the property is situated outside the country taxes levied by local authority is that country are deductible is deciding the annual value of the property. [*CIT v. R Venugopala Riddiar* (1965) 58 ITR 439 (Mad.)]

While calculating the annual value in accordance with Section 23(1) the following situations may arise:

- (i) If the property is let out throughout the previous year (No unrealised rent and no vacancy).
- (ii) If the property is let out throughout the previous year, but the entire rent could not be collected.
- (iii) If the entire rent is collected but the property remains vacant.
- (iv) If the property remains vacant and the entire rent is not collected.

From the above, it can be summarized that GAV would be calculated as follows:

Step 1: Determine Expected Rent and Actual Rent.

Expected Rent = Higher of Municipal Value or Fair Rent but subject to Standard Rent

Actual Rent = Rent for let out period – Unrealised Rent of relevant previous year

Step 2: If actual rent is more than Expected Rent than Actual rent otherwise expected Rent

Step 3: If property remain vacant and annual value decline due to vacancy then such decline value shall be considered

GAV = According to Step 2 (if no vacancy) and According to Step 3 (if vacancy is there)

Illustration 1

Mr. X is the owner of three houses, which are all let out and not governed by the Rent Control Act. From the following particulars find out the gross annual value in each case:

Particulars	I	II	III
	₹	₹	₹
Municipal Value	30,000	20,000	35,000
Actual (De facto) Rent	32,000	28,000	30,000
Fair Rent	36,000	24,000	32,000

Solution:

Gross Annual Value (GAV): Higher of Expected or Actual Rent

Expected Rent: Higher of Municipal Valuation or Fair Rent

House I: ₹ 36,000

House II: ₹ 24,000

House III: ₹ 35,000

Actual Rent (given)

GAV:

House I: ₹ 36,000

House II: ₹ 28,000

House III: ₹ 35,000

Illustration 2

Mr. X is the owner of four houses, which are all let out and are covered by the Rent Control Act. From the following particulars find out the gross annual value in each case, giving reasons for your answer:

Particulars	I	II	III	IV
	₹	₹	₹	₹
Municipal Value	30,000	26,000	35,000	30,000
Actual (De Facto) Rent	40,000	30,000	32,000	32,000
Fair Rent	36,000	28,000	30,000	36,000
Standard Rent	30,000	35,000	36,000	40,000

Solution

As all the houses are covered by the Rent Control Act, their gross annual value will be higher of expected Rent or Actual Rent. Expected Rent Shall be higher of Municipal Value or Fair rent but subject to Standard Rent:

Particulars	I	II	III	IV
	₹	₹	₹	₹
Expected Rent	30,000	28,000	35,000	36,000

Actual Rent	40,000	30,000	32,000	32,000
G.A.V.	40,000	30,000	35,000	36,000

- Annual letting value of self occupied property, subject to Rent Control Act is to be fixed on basis of standard rent and not on basis of open market *Tilak Raj v. CIT (1989) 45 Taxman 279/178 ITR 327 (Punj. & Har.)*.
- In determining annual value salary paid to caretaker cannot be taken into account *CIT v. Smt. Sreelekha Banerjee (1989) 45 Taxman 358/179 ITR 46 (Cal.)*.
- Loss relating to self occupied house property could be set off against income from other sources *CIT v. K.K. Dhanda (HUF) (1989) 45 Taxman 346/178 ITR 602 (Punj. & Har.)*.

Illustration [Situation (i)]

(i.e. no vacancy no unrealized rent)

X owns a house property. Municipal value ₹ 1,50,000, Fair Rent ₹ 1,25,000, Standard Rent ₹ 1,45,000. It is let out through out the previous year for ₹ 10,000 p.m. up to December 31, 2013 and ₹ 14,500 p.m. thereafter. Find out the Gross Annual Value for the Assessment Year 2014-15.

Solution

	₹
Municipal Value (a)	1,50,000
Fair Rent (b)	1,25,000
Standard Rent (c)	1,45,000
Actual Rent (10,000 x 9 + 14,500 x 3) (d)	1,33,500
Step 1: Expected Rent (a) or (b) whichever is higher, subject to (c)	1,45,000
Step 2: GAV = Higher of Expected or Actual Rent i.e. ₹ 1,45,000	

Illustration [Situation (ii)]

(i.e. No vacancy but there is unrealized rent)

Mr. A owns two houses. The expected rent of the house one is ₹ 65,000. This house was let out for ₹ 7,500 p.m. But the rent for the months of Feb. and March 2014 could not be realized.

The expected rent of another house is ₹ 1,50,000. This house was let out for ₹ 12,000 p.m. But the rent for the last three months could not be realized.

In the both cases, Mr. A fulfills the conditions of Rule 4. You are required to compute the Gross Annual Value of both the houses.

Solution

	₹	₹
	House I	House II
Expected Rent	65,000	1,50,000
Annual Rent	90,000	1,44,000
Unrealized Rent	15,000	36,000

Computation of Gross Annual Value

Step 1: Expected Rent	65,000	1,50,000
Step 2: Actual Rent (After deducting unrealized rent) if higher than Expected Rent then Actual rent otherwise Expected rent	75,000	N.A.
Step 3: Applicable only in case of vacancy	N.A.	N.A.
Gross Annual Value	75,000	1,50,000

Illustration [Situation (iii)]**(There is vacancy but no unrealized rent)**

Find out the gross annual value in the case of the following properties for the Assessment year 2014-15

	₹ in thousands			
	P	Q	R	S
Expected Rent	70	55	85	125
Rent Per Month (if let out)	7	5	8	8
Let out period (in months)	11	0	9	10
Vacancy (in months)	1	12	3	2

Further all the rent were realized for the year by the assessee.

Solution:

Calculation of Gross Annual Value of Mr. X for A.Y 2014-15

	P	Q	R	S
Annual Rent (If let out for 12 months)	84	60	96	96
Loss due to vacancy	7	60	24	16
Unrealized rent	Nil	Nil	Nil	Nil
Actual Rent (for let out period)	77	Nil	72	88

Calculation of Gross Annual Value

Step 1: Expected Rent	70	55	85	125
Step 2: If actual rent is more than Expected Rent than Actual rent otherwise expected Rent	77	N.A.	N.A.	N.A.
Step 3: If property remain vacant then decline due to vacancy shall be considered	40	0	72	109
Gross annual value	70	0	72	109

Illustration [Situation (iv)]**(Vacancy and unrealized rent both exist)**

Mr. X is the owner of a house property. He lets this property during the previous year 2013-14 for ₹ 7,000 p.m. The house was occupied from 1.4.2013 to 31.1.2014. From 1.2.2014, it remained vacant. Mr. X fails to realize ₹ 10,000 from the tenant. The Expected rent of the house is ₹ 82,000 p.a.

Calculate the Gross Annual Value of the house.

Solution

	₹
Expected Rent	82,000
Annual Rent (Actual for the whole year – 7000 x 12)	84,000
Actual Rent (7,000 x 10)	70,000
Unrealized rent	10,000
Realized rent (₹ 70,000 – 10,000)	60,000
Loss Due to vacancy (84,000 – 70,000 for 2 months)	14,000
Decline due to vacancy (₹ 82,000 – 14,000) but not less than actual rent received	68,000

Calculation of Gross Annual Value

Step 1: Expected Rent	82,000
Step 2: If actual rent is more than expected rent than actual rent otherwise expected rent	N.A.
Step 3: Decline due to vacancy in Expected Rent (i.e. Expected Rent minus Loss due to vacancy but not less than actual rent received)	68,000
Gross Annual Value	68,000

B. Property occupied by the owner [Section 23(2)]

Where the property consists of one house or part of a house in the occupation of the owner for his own residence, and is not actually let during any part of the previous year and no other benefit is derived therefrom by the owner, the annual value of such a house or part of the house shall be taken to be nil. The only deduction available in respect of such house is towards interest on borrowed capital in terms of

Section 24(1)(vi) but subject to a ceiling of ₹ 30,000 or ₹ 1,50,000 as the case may be.. In other words, to this extent there could be a loss from such house.

Concession for one House only:

Where the assessee has occupied more than one house for the purposes of residence for himself and family members, he has to make a choice of one house only in respect of which he would like to claim exemption. Other self-occupied houses will be treated as if they were let out and their annual value will be determined in the same manner as we have discussed in the case of let out property.

The concessions in respect of self occupied residential house are available to an individual or H.U.F. assessee. Firms, companies, etc. are not considered to have used a house for their residential purposes. A partnership firm using its own building for the residence of its partners cannot claim the concessions in respect of self occupied residential house mentioned above C.I.T. v. Dewan Chand Dholan Das (1981) 132 ITR 790. Similarly, these concessions are not available in a case where the assessee lets out his house to his employer and employer allots the same to the assessee for his residential purposes. In such a case, the assessee occupies the house not as an owner but as a sub tenant of his employer D.R. Sunder Raj v. C.I.T. (1979) 2 Taxman 458 (A.P.).

In respect of such house, no deduction whatsoever is allowed except interest upto ₹ 30,000 or ₹1,50,000 as the case may be on the borrowed capital. In other words, a loss to the maximum extent of ₹ 30,000 or ₹1,50,000 can

be reported in respect of such houses. If any property is purchased or constructed out of funds borrowed on or after 1st April, 1999, the restriction on the amount of interest deductible in respect of such self-occupied houses shall be relaxed so as to secure a deduction upto ₹ 1,50,000 provided the purchase/construction is completed within three years from the end of the financial year in which capital was borrowed.

Illustration

Mr. R owns a house which uses for residential purposes throughout the previous year 2013-14. Municipal Value: ₹ 2,40,000. Fair Rent: ₹ 3,00,000. Compute income from house property assuming following expenditure are incurred by him:

Municipal taxes paid: ₹ 15,000

Repairs: ₹ 12,000

Depreciation: ₹ 10,000

Interest on borrowed capital : ₹ 2,00,000 (loan taken on 1.1.2001). House was purchased on 1.5.2002.

Solution:

Income from House Property:

Net Annual Value	Nil
Less: Interest on borrowed capital (lower of ₹ 2,00,000 or 1,50,000 as conditions are satisfied)	1,50,000
Loss from House Property	(1,50,000)

C. House which is Partly Self-occupied and Partly Let Out:

In such a case, the procedure for computation of annual value is as follows :

(a) Property let out partially :

When a portion of the house is self-occupied for the full year and a portion is self-occupied for whole year, the annual value of the house shall be determined as under:

- From the full annual value of the house the proportionate annual value for self-occupied portion for the whole year shall be deducted.
- The balance under (i) shall be the annual value for let out portion for a part of the year.

Illustration

Mr. R. owns a house. The Municipal value of the house is ₹ 50,000. He paid ₹8,000 as local taxes during the year. He uses this house for his residential purposes but lets out half of the house @ ₹ 3,000 p.m. Compute the annual value of the house.

Solution

	₹
Annual rent or Municipal valuation (higher)	72,000
Less : Local taxes paid	8,000
Annual value of House Property	64,000
Less : Half of annual value regarding self occupied portion for the whole year	32,000
Annual Value of let out portion	16,000

(b) House let out during any part of the previous year and self occupied for the remaining part of the year:

In this case the benefit of Section 23(2) is not available and the income will be computed as if the property is let out.

Illustration

M is the owner of a house. The municipal value of the house is ₹ 40,000. He paid ₹ 8,000 as local taxes during the year. He was using this house for his residential purposes but let out w.e.f. 1.1.2013 @ ₹ 4,000 p.m. Compute the annual value of the house.

Solution

	₹
Annual rent or municipal valuation (whichever is higher)	48,000
Less : Local taxes	8,000
Annual value of the house	40,000

(No benefit shall be given for self occupied period as the house did not remain vacant during the previous year)

Note: If fair rent is not given, then assume actual rent as fair rent.

(c) Self-occupied House remaining vacant :

If the assessee has reserved only one of the houses (owned by him) for his residence or he is the owner of only one house which is meant for his own residence but could not be occupied by him for residential purposes in the previous year owing to the fact that he had to live at some other place in a house not belonging to him, then he can claim non-occupation or vacancy allowance during the previous year for the period during which house remained vacant. The reason for his living at a different place might be for business or professional purposes or for a salaried employee due to transfer etc. The annual value of the house, which remained vacant in these circumstances, shall be nil.

The above mentioned concession will be granted to the assessee only if he has neither let out the said house nor has derived any benefit from it during the period for which it remained vacant. No deduction, except interest on borrowed capital upto a maximum of ₹ 30,000 is allowed in computing income from such a house. This amount of ₹ 30,000 has been increased by Finance Act, 2001 w.e.f. AY 2002-03 to ₹ 1,50,000 where property is acquired or constructed with capital borrowed on or after the 1st day of April 1999 and such acquisition or construction is completed within three years from the end of the financial year in which capital was borrowed.

D. Property owned by co-owners (Section 26)

Where the property consisting of building or buildings and lands appurtenant thereto is owned by two or more persons and their respective shares are definite and ascertainable, the share of each such person shall be included in his total income and they shall not be assessed as an association of persons and share of each co-owner shall be computed as if each such person is individually entitled to the relief provided in Section 23(2).

Income from property held under trust for charitable or religious purposes is exempt from tax under Section 11.

DEDUCTIONS FROM INCOME UNDER THE HEAD HOUSE PROPERTY (SECTION 24)

W.e.f. Assessment Year 2002-03, income chargeable under the head "Income from house property" shall be computed after making the following deductions, namely:

(a) Standard deduction

A sum equal to 30% of the annual value;

(b) Interest on borrowed capital

Where the property has been acquired, constructed, repaired, renewed or reconstructed with borrowed capital, the amount of any interest payable on such capital:

Provided that in respect of property referred to in sub-section (2) of section 23, the amount of deduction shall not exceed ₹ 30,000:

Provided further that where the property referred to in the first proviso to acquired or constructed with capital borrowed on or after the 1st day of April, 1999 and such acquisition or construction is completed within three years from the end of the financial year in which capital was borrowed, the amount of deduction under this clause shall not exceed ₹ 1,50,000.

Explanation. – Where the property has been acquired or constructed with borrowed capital, the interest, if any, payable on such capital borrowed for the period prior to the previous year in which the property has been acquired or constructed, as reduced by any part thereof allowed as deduction under any other provision of this Act, shall be deducted under this clause in equal instalments for the said previous year and for each of the four immediately succeeding previous years (means in 5 equal instalments):

Provided also that no deduction shall be made under the second proviso unless the assessee furnishes a certificate, from the person to whom any interest is payable on the capital borrowed, specifying the amount of interest payable by the assessee for the purpose of such acquisition or construction of the property, or, conversion of the whole or any part of the capital borrowed which remains to be repaid as a new loan.

Explanation. – For the purposes of this proviso, the expression “new loan” means the whole or any part of a loan taken by the assessee subsequent to the capital borrowed, for the purpose of repayment of such capital.

Amounts not deductible from income from house property (Section 25)

Where the amount of interest on money borrowed for the purpose of house property is payable outside India and it is chargeable under the Act, it shall not be allowed as a deduction unless:

- (i) tax has been paid or deducted at source in respect of such payment, or
- (ii) there is a person in India who may be treated as an agent or representative of the non-resident to whom such payments have been made.

DEDUCTION IN RESPECT OF INTEREST ON HOUSING LOAN UNDER SECTION 80EE

Keeping in view the need for affordable housing, an additional benefit for first-home buyers is provided by inserting a new section 80EE in the Income-tax Act relating to deduction in respect of interest on loan taken for residential house property.

The new section 80EE seeks to provide that in computing the total income of an assessee, being an individual, there shall be deducted, in accordance with and subject to the provisions of this section, interest payable on loan taken by him from any financial institution for the purpose of acquisition of a residential house property.

The amount of deduction shall not exceed one lakh rupees and shall be allowed in computing the total income of the individual for the assessment year beginning on 1st April, 2014 and in a case where the interest payable for the previous year relevant to the said assessment year is less than one lakh rupees, the balance amount shall be allowed in the assessment year beginning on 1st April, 2015.

This section will be discussed in detail under Lesson No. 6

SPECIAL PROVISION FOR CASES WHERE UNREALISED RENT ALLOWED AS DEDUCTION IS REALISED SUBSEQUENTLY (SECTION 25A)

This section provides that where deduction has been allowed under

Section 24(1)(x) (as it stood immediately before its substitution by the Finance Act, 2001) in respect of unrealised rent and subsequently during any previous year the assessee has realised any amount in respect of such rent, the amount so realised will be deemed as income under the head “Income from house property” and accordingly charged to tax (without making any deduction under Section 23 or 24, as it stood immediately before its substitution by the Finance Act, 2001) as the income of that previous year, irrespective of whether the assessee is the owner of that property in that year or not.

The above list of allowable expenses is exhaustive and no other expenses, such as, commission on arranging

loans for house property or succession duty in respect of house property or expenses of tenancy agreement shall be allowed as deductions.

W.e.f. Assessment Year 2002-03, no deduction under Section 24(1) is allowable in respect of unrealised rent as under the amended provision of determination of annual value, it will be already adjusted while computing the annual value. Consequently Section 25A will be applicable only for the recovery of that unrealised rent which has been allowed as deduction upto Assessment Year 2001-02.

Unrealised rent received subsequently to be charged to income-tax (Section 25AA)

A new Section 25AA has been inserted as under to tax the recovery of unrealised rent, as such unrealised rent must have been considered while determining the annual value for assessment year 2002-03 and onwards.

Where the assessee cannot realise rent from a property let to a tenant and subsequently the assessee has realised any amount in respect of such rent, the amount so realised shall be deemed to be income chargeable under the head "Income from house property" and accordingly charged to income-tax as the income of that previous year in which such rent is realised whether or not the assessee is the owner of that property in the previous year.

Taxation of arrears of rent in the year of receipt (Section 25B)

Section 25B inserted in the Income-tax Act w.e.f. assessment year 2001-2002 provides that if any arrears of rent, other than what has already been taxed under Section 23, are received in a subsequent year, the same will be taxed in the year of receipt whether the property is owned by the assessee in the year of receipt or not. A deduction of sum equal to 30% of such amount of rent shall be allowed towards repairs and collection of rent.

LOSS FROM HOUSE PROPERTY

When the aggregate amount of permissible deduction exceeds the net annual value of the property, there will be a loss from that property. This loss can be set-off against the income from any other house property. If even after the set-off, there is an unabsorbed balance of the loss, the same can be set-off against income under any other head in the same year and the balance unabsorbed part of the loss can be carried forward in terms of Section 71B for set off within the subsequent eight assessment years against income from house property. However, where the self-occupied property consists of one residential house only and it could not be occupied by the owner for the reasons that owing to his employment, business or profession carried on at any other place, he had to reside at that other place in a building not belonging to him (rented or otherwise), the loss can neither be set-off against the income from any other house nor can it be set-off against the income under any other head.

Chart Showing Computation of Taxable Income from House Property

Gross Annual Value of the house		XXX
Less: Local Taxes paid by the owner during the previous year		<u>XXX</u>
Annual Value		XXX
Less: Deduction under Section 24: For house let out or deemed to be let out:		
(i) Repairs and Collection Charges (30% of Annual Value)		XXX
(ii) (a) Interest on loan, taken for purchase, construction of repair of the house, relating to previous year		XXX
(b) Interest on loan for the period prior to the previous year in which the house is completed is also allowable in five equal annual instalments		<u>XXX</u> <u>XXX</u>
Taxable Income from House Property		XXX

Illustration:

Mr. X is the owner of four houses. The following particulars are available:

	House 1	House 2	House 3	House 4
	₹	₹	₹	₹
Municipal valuation	16,000	20,000	24,000	5,600
Rent (Actual)	—	14,000	20,000	6,800
Municipal taxes	400	1,000	1,200	300
Repairs and collection charges	200	2,500	1,040	460
Interest on mortgage	—	—	—	1,000
Ground rent	—	100	—	60
Fire premium	140	—	200	—
Annual charges	—	—	360	—

House No. 1 is self-occupied.

House No. 2 is let out for business, construction was completed on 1.3.90 and consists of two residential units.

House No. 3 is 3/4 used for own business 1/4 let out to the manager of the business.

House No. 4 is let out for residential purposes.

His other income is ₹ 30,000. Find out the income of X from house property for the assessment year 2014-15.

Solution:*House No. 1*

	₹
Municipal valuation	16,000
Annual value deemed to be	NIL

House No. 2

Fair rental value	20,000
Less: Municipal taxes	<u>1,000</u>
Net annual value	19,000
Less: 30% of Net Annual Value	<u>5,700</u>
	<u>13,300</u>

House No. 3

Since the house is used for own business, the income from this house is not taxable under the head 'Income from house property' but will be assessed under 'Profit and gains of business or profession'. 1/4 of the house occupied by the Manager is presumed to be incidental to the business and hence not assessable under the head 'Income from house property'.

House No. 4

	₹
Rent Received	6,800
Less: Municipal taxes	300
Net annual Value	6,500
Less: 30% of Net Annual Value	1,950
	4,550

Income from House Property : ₹ NIL + ₹ 13,300 + ₹ 4,550 = ₹ 17,850. It is presumed that House No. 4 has not been mortgaged for purposes of acquiring or repairs on the house property.

Illustration

Mr. and Mrs. O.P. Gupta are co-owners of a property having equal shares. The construction of the property was begun in July 1991 and completed in September 1996. They furnished the following particulars for the assessment year 2014-15 in respect of the property.

One-third of the property is occupied by the co-owners and the remaining two-thirds is let for residential purposes. The let out portion which constitutes two units fetches rent of ₹ 27,000 per annum. The letting value of the property as per municipal records is ₹ 36,000. Municipal taxes of ₹ 4,050 have been paid by the co-owners. Besides, they paid ₹ 1,350 as ground rent and ₹ 900 as insurance premium. The co-owners also paid ₹ 9,000 as interest on loan taken for the construction of the house.

Compute the income from the house property from the assessment year 2014-15 if other incomes of Mr. and Mrs. O.P. Gupta are ₹ 60,000 and ₹ 22,500 respectively during the same period.

Solution**Computation of income from house property for the assessment year 2014-15****LET OUT PORTION**

Gross annual value: To be higher of the following:

	₹	₹
(a) Notional income based on municipal valuation 2/3 x ₹ 36,000 = ₹ 24,000 or		
(b) Annual rent = ₹ 27,000 Gross Annual Value	27,000	
Less: Full municipal taxes paid by the co-owners 2/3 x ₹ 4,050 = ₹ 2,700		(2,700)
Net Annual Value		24,300
Less: Deduction from net annual value:		
(i) 30% of Net Annual Value	7,290	
(ii) Interest on loan taken for the construction of the house 2/3 x ₹ 9,000 = ₹ 6,000	6,000	<u>13,290</u>
Taxable income		<u>11,010</u>

Share of Mr. Gupta	₹ 5,505
Share of Mrs. Gupta	₹ 5,505

SELF-OCCUPIED PORTION

Gross annual value: to be higher of the following:

- (i) Municipal valuation:
 $1/3 \times ₹ 36,000 = ₹ 12,000$ or

(ii) Fair rent ($₹ 27,000 \times 3/2 \times 1/3$) $₹ 13,500$

Gross Annual Value

Annual Value

	Share of Mr. Gupta	Share of Mrs. Gupta
	₹	₹
Apportionment of Annual value among the co-owners 1 : 1	6,750	6,750
Annual value of self-occupied property for each co-owner is taken to be [Section 23(2)(a)(i) read with explanation to Section 26]	Nil	Nil
<i>Less: Deduction from net annual value:</i>		
Interest on loan	<u>1,500</u>	<u>1,500</u>
Loss: under the head house property	<u>(-)1,500</u>	<u>(-)1,500</u>
<i>Statement of total income from house property:</i>		
Let out portion	5,505	5,505
Self-occupied portion Loss:	<u>(-)1,500</u>	<u>(-)1,500</u>
	4,005	4,005

Illustration

Mr. Lal is the owner of a house property. Its municipal valuation is ₹ 80,000. It has been let out for ₹ 1,20,000 p.a. The local taxes payable by the owner amount to ₹16,000 but as per agreement between the tenant and the landlord, the tenant has paid the amount direct to the municipality. The landlord, however, bears the following expenses on tenant's amenities:

	₹
Extension of water connection	3,000
Water charges	1,500
Lift maintenance	1,500
Salary of gardener	1,800
Lighting of stairs	1,200
Maintenance of swimming pool	750

The landlord claims the following deductions:

Repairs and Collection charges	7,500
Land revenue paid	1,500

Compute the taxable income from the house property for the assessment year 2014-15.

Solution

Computation of income from house property for the assessment year 2014-15

Gross annual value: to be higher of the following:

- | | ₹ | ₹ |
|--|---|---|
| (a) Municipal valuation ₹ 80,000 | | |
| or | | |
| (b) De facto rent (₹ 1,20,000 less value of amenities) | | |

Rent Received: 1,20,000

Less: Value of the amenities provided by the assessee:

- | | | |
|---|-------|----------|
| (i) Extension of water connection not deductible as it is capital expenditure | | |
| (ii) Water charges | 1,500 | |
| (iii) Lift maintenance | 1,500 | |
| (iv) Salary of gardener | 1,800 | |
| (v) Lighting of stairs | 1,200 | |
| (vi) Maintenance of swimming pool | 750 | (6,750) |
| Gross annual value | | 1,13,250 |

Less: Local tax ₹ 16,000:

- | | |
|---|----------|
| No deduction is permissible as the taxes have been paid by the tenant | — |
| Net annual value | 1,13,250 |

Less: Standard deduction from net annual value:

- | | |
|----------------------------|--------|
| 30% of Net Annual Value | 33,975 |
| Income from house property | 79,275 |

Illustration

X owned two house properties - the first of which was used half for running his business and the other half was let out at ₹ 3,000 per month. The second property was wholly used as a residence by X. Municipal taxes for the two properties were the same at ₹ 7,200 each per annum. The business and the let out premises were insured against loss by fire and the insurance premium was ₹ 900. Compute X's income from house property.

Solution**Computation of income under the head 'Income from house Property'**

	₹
FIRST PROPERTY (LET OUT PORTION)	
Gross annual value (3,000 x 12)	36,000
Less: Municipal taxes	<u>(3,600)</u>
Net annual value	32,400
Less: Deduction under Section 24 (30% of Net Annual Value)	<u>9,720</u>
	<u>22,680</u>
Income from first property - Let out portion	22,680
Income from first property - used for business	NIL
Income from second property - self occupied	NIL
Income under the head 'Income from house property'	22,680

Notes:

1. Income from one self occupied property is to be taken as nil.
2. Income from property used for the assessee's own business is to be taken as nil.

Illustration

For the assessment year 2014-15 Sonu submits the following information:

Income from business (speculative)	₹ 40,000	
<i>Property Income</i>	<i>House I</i>	<i>House II</i>
	₹	₹
Municipal valuation	35,000	80,000
Rent received	38,000	68,000
Municipal taxes paid by tenant	3,000	4,000
Repairs paid by tenant	500	18,000
Land revenue paid	2,000	16,000
Insurance premium paid	500	2,000
Interest on borrowed capital for payment of municipal tax of house property	200	400
Nature of occupation	Let out for residence	Let out for business
Date of completion of construction	1.4.1995	1.7.1993

Determine the taxable income of Sonu for the assessment year 2014-15.

Solution:

Computation of Taxable Income of Sonu for Assessment Year 2014-15

₹

House I

Gross Annual Value	38,000
Less: Municipal Taxes - not deductible since paid by tenant	<u>NIL</u>
Net Annual Value	38,000
Less: 30% of Net Annual Value	<u>11,400</u>
Taxable Income	<u>26,600</u>

House II

Gross Annual Value	80,000
Less: Taxes - not deductible, paid by tenant	<u>NIL</u>
Net Annual Value	80,000
Less: 30% of Net Annual Value	<u>24,000</u>
Taxable Income	<u>56,000</u>

Total Income = ₹26,600 + ₹56,000 + ₹40,000 = ₹1,22,600.

Note: Interest on borrowed capital for payment of municipal tax is not allowed as deduction under Section 24 of the Act.

EXEMPTIONS

(A) Items of income from house property which are exempt from Income-tax are:

- (i) Income from house property situated in the immediate vicinity of or on the agricultural land and used as a dwelling house, store-house or other out-house by the cultivator or receiver or rent-in-kind. [Section 2(1A) read with Section 10(1)].
- (ii) Income from property held under trust for charitable or religious purposes (Section 11).
- (iii) Income from property occupied by the owner for the purposes of his business or profession carried on by him and the profits of which are chargeable to Income tax. If the profits of business or profession are not chargeable to tax because the income of that business or profession is exempt from tax, the income from the house property shall be chargeable under this head (Section 22).
- (iv) Income from residential house where the house consists of one residential house only and it could not be occupied by the owner on account of his employment, business or profession carried on at any other place and he lives at such place in a house which does not belong to him. The income shall be exempt provided:
 - (a) The house was not occupied by the owner during the whole of the previous year; or
 - (b) The house was not let; or
 - (c) No other benefit was derived by the owner [Section 23(3)].
- (v) Income from house property belonging to a Registered Trade Union [Section 10(24)].

- (vi) Income of an authority constituted under any law for the time being in force for the marketing of commodities; any income derived from the letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities [Section 10(29)].
- (vii) The annual value of any one palace in the occupation of an ex-ruler [Section 10(19A)].
- (viii) Income from house property belonging to a local authority [Section 10(20)].
- (ix) Income from property of an authority constituted for the purpose of planning, development, or improvement of cities, towns and villages [Section 10(20A)].
- (x) Income from property of the approved scientific research association subject to fulfillment of certain conditions [Section 10(21)].
- (xi) Income from property of a games association [Section 10(23)].
- (xii) Income from property in the case of a person resident of Ladakh. [Section 10(26A)].
- (xiii) Income from property of a political party (Section 13A).

(B) Income which are included in gross total income but do not form part of the total income:

- (i) Income of a co-operative society from the letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities [Section 80P(2)(e)].
- (ii) Income from house property of a co-operative society, not being a housing society or an urban consumers society or a society carrying on transport business or a society engaged in any manufacturing operations with the aid of power, where the gross total income of the society does not exceed rupees twenty thousand [Section 80P(2)(f)].

LESSON ROUND UP

- **Charging Section:** Section 22 of the Act provides that the annual value of property consisting of any buildings or lands appurtenant thereto of which the assessee is the owner, other than such portions of such property as he may occupy for the purposes of any business or profession carried on by him, the profits of which are chargeable to income-tax, shall be chargeable to income-tax under the head Income from House Property”.
- **Deemed Owner:** As per section 27, the following persons though not the legal owners of a property are deemed to be the owners for the purposes of sections 22 to 26:
 - (a) Transfer to a spouse or minor child
 - (b) Holder of an imitable estate
 - (c) Member of a co-operative society
 - (d) Person in possession of a property
 - (e) Person having right in a property for a period not less than 12 years
- The measure of charging income-tax under this head is the annual value of the property, i.e., the inherent capacity of a building to yield income. The expression ‘annual value’ has been defined in Section 23(1) of the Income-tax Act as, the **annual value** of any property shall be **deemed to be**:
 - the sum for which the property might **reasonably be expected to let from year to year**; or
 - where the property or any part of the property is let and the actual rent received or receivable by

the owner in respect thereof is in excess of the sum referred to in clause (a), the amount so received or receivable; or

- where the property or any part of the property is let and was vacant during the whole or any part of the previous year and owing to such vacancy the actual rent received or receivable by the owner in respect thereof is less than the sum referred to in clause (a), the amount so received or receivable.
- **Gross annual value** shall be higher of
 - (a) Expected Rent
 - (b) Actual rent received or receivable.

The higher of Municipal value and fair rental value shall be **Expected rent**. However, expected rent shall not exceed the Standard rent.

- Net annual value shall be computed in the following manner:
 - Determine the Gross Annual Value
 - Deduct municipal tax actually paid by the owner during the previous year from the Gross Annual Value.
- **Deduction from Annual Value (Section 24):** W.e.f. Assessment Year 2002-03, income chargeable under the head "Income from house property" shall be computed after making the following deductions, namely:

Standard deduction: a sum equal to 30% of the annual value;

Interest on borrowed capital: where the property has been acquired, constructed, repaired, renewed or reconstructed with borrowed capital, the amount of any interest payable on such capital. The interest on borrowed money pertaining to pre-construction period is available in 5 equal installments commencing from the previous year in which house is acquired or constructed. For this purpose the pre-construction period means the period commencing on the date of borrowing and ending on 31st March immediately prior to the date of completion of construction/date of acquisition or date of repayment of loan, whichever is earlier. Interest for current year is deductible upto Rs. 30,000/Rs.1,50,000 as the case may be.

SELF TEST QUESTIONS

These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation.

MULTIPLE CHOICE QUESTIONS

1. Abbhi is the owner of a house, the details of which are given below :

Municipal value ₹ 30,000

Actual rent ₹ 32,000

Fair rent ₹ 36,000

Standard rent ₹ 40,000.

The gross annual value would be –

- (a) ₹ 36,000
- (b) ₹ 35,000
- (c) ₹ 30,000

- (d) ₹ 40,000.
2. Sunil purchased a house for his residential purpose after taking a loan in January, 2013. During the previous year 2013-14, he paid interest on loan ₹ 1,67,000. While computing income from house property, the deduction is allowable to the extent of —
- ₹.30,000
 - ₹ 1,00,000
 - ₹ 1,67,000
 - ₹ 1,50,000.
3. Expected rent shall be higher of the;
- Municipal value and standard rent
 - Fair rent and actual rent received
 - Standard rent and Fair rent
 - Municipal Value and Fair rent.
4. Municipal Value ₹ 14,000, Fair rent ₹ 14,500, Standard Rent ₹ 14200, Actual rent as property let out throughout the previous year ₹ 16800. Unrealised rent of the previous year ₹ 7,000. The annual value of the house property shall be
- ₹ 9,800
 - ₹ 14,200
 - ₹ 7,200
 - ₹ 7,500

FILL IN THE BLANKS

- Rent received by original tenant from sub-tenant is taxable under the head _____.
- The net annual value of house let-out is ₹ 1,00,000 and actual amount spent by the assessee on repairs and insurance premium is ₹ 20,000, the amount of deduction allowed under section 24(a) shall be ₹ _____.
- Rent from house property let-out by an assessee to his employees when such letting is incidental to his main business, will be chargeable to tax under the head _____.
- When annual value of one-self occupied house is nil, the assessee will be entitled to the standard deduction @ _____.

DISTINGUISH BETWEEN

- Gross Annual Value and Annual Value
- Deemed owners and Actual owners
- Standard Rent and Expected Rent
- Fair Rent and Annual Rent

ELABORATIVE QUESTIONS

- What is the meaning of 'Owner of House Property' under Section 27 of the Income-tax Act, 1961?

2. What is 'annual value' of house property? How is it computed?
3. In computing the income from house property what deductions are allowed from the net annual value?
4. What is the basis of computation of income from House property? How would you arrive at the net annual value of a house occupied by an assessee for his own residence?
5. How would you deal with the following while calculating the income under 'Income from house property':
 - (a) Annual Charge.
 - (b) Vacancy Allowance.
 - (c) Unrealised Rent.
 - (d) Income from house property situated in a foreign country.

PRACTICAL QUESTIONS

1. Sanjay owns a house property. Following are the details about the property :

Municipal value of house : ₹72,000 per annum.

Fair rent of house : ₹66,000 per annum.

Standard rent of house : ₹60,000 per annum.

The house was let out at ₹6,000 per month but was sold on 1st January, 2014. Find out income from house property for the assessment year 2014-15.

2. Nayan owns a house at Indore. Its municipal valuation is ₹24,000. He incurred the following expenses in respect of the house property :

Municipal tax @ 20%, fire insurance premium ₹2,000 and land revenue ₹2,400. He took a loan of ₹25,000 @16% per annum on 1st April, 2010. The whole amount is still unpaid. The house was completed on 1st April 2013. Find out the income from house property for the assessment year 2014-15 in respect of the following options :

- (a) If the house is used by the assessee throughout the previous year for his residential purpose; and
 - (b) If the house is let-out for residential purposes on monthly rent of ₹2,000 from 1st April, 2013 to 31st January, 2014 and self-occupied for the remaining period.
3. Krishan submits the following information for the assessment year 2014-15 :

Property income	House-A	House-B
	₹	₹
Municipal valuation	17,500	40,000
Municipal taxes paid by tenant	1,500	2,000
Land revenue paid	1,000	8,000
Rent received	19,000	34,000
Insurance premium paid	250	1,000
Repairs paid by tenant	250	9,000

Interest on borrowed capital for payment of municipal tax of house property	100	200
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Nature of occupation	Let out for residence	Let out for business
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Date of completion of construction	1.4.2000	1.4.1998
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Determine the taxable income of Krishan for the assessment year 2014-15.

4. Anubhav owns three houses, the particulars of which are given below :

	House-A	House-B	House-C
	₹	₹	₹
Municipal value	80,000	1,20,000	1,00,000
Fair rent	90,000	1,00,000	1,10,000
Monthly rent	8,000	9,000	12,000
Rent collection charges	8,000	10,000	6,000
Repair expenses	5,000	6,000	4,000
Interest on loan :			
– For construction	40,000	—	—
– For marriage of son	—	30,000	—
– For repairs	—	—	8,000
Commencement of construction	04.04.2006	04.01.2008	04.07.2009
Completion of construction	31.03.2010	30.06.2010	31.12.2011
Use by tenant	Residential	Office	Residential

Municipal tax is charged @ 10%. Anurag paid municipal tax of House-A but did not pay municipal tax of House-B. The tenant paid the municipal tax of House-C which remained vacant for 3 months. Compute income from house property of Anurag for the assessment year 2014-15.

5. Rohit is the owner of a house property, its municipal valuation is ₹ 80,000. It has been let-out for ₹ 1,20,000 per annum. The local taxes payable by the owner amount to ₹ 16,000, but as per agreement between the tenant and the landlord, the tenant has paid the amount direct to the municipality. The landlord, however, bears the following expenses on tenant's amenities :

	₹
Extension of water connection	3,000
Water charges	1,500
Lift maintenance	1,500
Salary of gardener	1,800
Lighting of stairs	1,200
Maintenance of swimming pool	750

The landlord claims the following deductions :

Repairs and collection charges	7,500
Land revenue paid	1,500

Compute the taxable income of Rohit from the house property for the assessment year 2014-15.

ANSWERS/HINTS

Multiple choice question

1. (a); 2. (d); 3. (d); 4. (b)

Fill in the Blank

1. Other sources; 2. ₹ 30,000; 3. 'Profit and Gains from Business or Profession'; 4. Nil

Practical questions

1. ₹ 37,800; 2. (a) (-) 6400; (b) 7,000; 3. ₹ 41,300; 4. 21600, 84,000, 67,600; 5. ₹ 77,175

SUGGESTED READING

1. Dr. V.K. Singhania : Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.

2. Girish Ahuja and Ravi Gupta : Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.

Lesson 4

Part III : Income From Business or Profession

LESSON OUTLINE

- ‘Business’ or ‘Profession’
- Income Chargeable to Income-Tax (Section 28)
- Profits and Losses of Speculation Business
- How Profits and Gains are Computed
- Deductions Allowable
- Expenses Restricted/Disallowed
- Deemed Profits
- Special Provision for Deductions in the Case of Business for Prospecting etc. for Mineral Oil (Section 42)
- Special Provisions Consequential to the Changes in the Rate of Exchange of Currency
- Special Provision for Computation of Cost of Acquisition of Certain Assets (Section 43C)
- Special Provision in Case of Income of Public Financial Institutions, etc. (Section 43D)
- Insurance Business
- Special Provisions for Deduction in the Case of Trade, Professional or Similar Associations
- Maintenance of Accounts (Section 44AA)
- Compulsory Audit of Accounts of Certain Persons Carrying on Business or Profession
- Provision for Computing Profits and Gains of Business of Civil Construction etc. (Section 44AD)
- Special Provisions for Computing Profits and Gains of Business of Plying, Hiring or Leasing Goods Carriages
- Special Provisions for Computing Profits and Gains of Retail Business (Section 44AF)
- Special Provisions for Computing Profits and Gains of Shipping Business in case of Non-Residents (Section 44B)
- Deduction of Head Office Expenditure in case of Non-Residents (Section 44C)
- Computation of Income by way of Royalty etc. in case of Foreign Companies (Section 44D)

LEARNING OBJECTIVES

The provisions for computation of Income from Business and Profession are covered under sections 24 to 44D. This lesson deals with the provisions for computation of Income from Business and Profession. Section 28 defines the scope of income which can be taxed under this head. Expenses/allowances expressly allowed by the Act are listed under sections 29 to 37, whereas sections 40, 40A and 43B enumerate those expenses which are expressly disallowed while computing taxable income.

At the end of this lesson, you will learn –

- what are the constituent of business or profession.
- which incomes are chargeable under this head.
- which are admissible/inadmissible expenses while computing the income from business and profession.
- when certain receipts are deemed to be income chargeable to tax under this head.
- which are the deductions allowable on actual payment basis.
- which are the assessees who required to compulsorily maintain books of account.
- when audit of accounts is compulsory.
- who are the assessees to whom presumptive tax provisions apply.

'BUSINESS' OR 'PROFESSION'

The most important head of income is the head 'Profits and gains of Business or Profession'. While the provisions of Sections 28 to 44D deal with the method of computing income under head "Profits and Gains of Business or Profession".

Meaning of Business

- The meaning of the expression 'Business', has been defined in Section 2(13) of the Income-tax Act. According to this definition, business includes any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture.

The concept of business presupposes the carrying on of any activity for profit, the definition of business given in the Act does not make it essential for any taxpayer to carry on his activities constituting business for a considerable length of time.

- In other words, for even a single or isolated transaction entered into with the idea of making profit would be a business within the meaning of the definition given in Section 2(13). The concept of business presupposes the existence of the assessee's intention to make a profit out of his transactions.
- The object to make profit must be inherent in the transaction although the ultimate result of the transaction may be such that the assessee had to incur loss. Thus, the assessability of profits and gains from business under this head does not in any way depend upon the ultimate outcome of the venture or transaction yielding income or loss.

A loss incurred from business is as much assessable under this head as profit which is chargeable to tax. There may be cases where a tax payer may acquire an asset not with the idea of selling it at a profit but to retain it as his own investment. In such cases the profit or gain derived from the sale or other transfer of such an investment would constitute a capital profit which cannot be charged to tax under the head 'income from business or profession'. However, if the same assessee who holds some investments, decides at a later point of time to convert this investment into stock-in-trade and deals with them as part of his business assets in the normal course of his business, the profit or gain derived from the sale of the same asset in the ordinary course of the business would constitute income assessable under this head. The fact that the asset concerned was originally acquired without the idea of making profit on sale, is immaterial for the purpose of assessment.

Thus, the concept of business presupposes an operation consisting substantially of production or sale or purchase and sale or making arrangements for the production, sale etc. of commodities. Thus, an agency which does not involve actual purchases or sale but acting as intermediary would also constitute the carrying on of a business.

- The definition of business given in Section 2(13) is so wide as to cover every case of transaction entered into with the idea of earning income.

Example: If a person purchases a piece of land, gets it surveyed, lays down a scheme of development, divides it into a number of building plots and sells some of the plots from time to time, he would be chargeable to tax not only on the notional profits made on individual sale of plots but also on the surplus, if any, remaining after the sale of all plots and after the venture had come to an end.

Meaning of Profession

- The expression 'Profession' has been defined in Section 2(36) of the Act to include any vocation. In the case of a profession, the definition given in the Act is very much inadequate since it does not clearly specify what activities constitute profession and what activities do not.

- According to the generally accepted principles, the meaning of the term 'profession' involves the concept of an occupation requiring either intellectual skill or manual skill controlled and directed by the intellectual skill of the operator.
- For instance, an auditor carrying on his practice, the lawyer or a doctor, a painter, an actor, an architect or sculptor, would be persons carrying on a profession and not a business.
- The common feature in the case of both profession as well as business is that the object of carrying them out is to derive income or to make profit. The process of making the profit would be the main area of difference between the two while the ultimate object is common to both.

Continuity of Business or Profession

As has already been mentioned, the existence of continuity in the business or profession is not an essential condition for making the assessee liable to tax under this head. Thus, receipts arising from the exercise of a business or profession would still be chargeable to tax under this head although they may be both casual and non-recurring in nature. Consequently, the exemption available under Section 10(3) for receipt of a casual and non-recurring nature would not be available to income derived from business although carrying on the business would be casual and the receipt of income may be such that it does not recur at all. In determining the taxability of profit under the head business or profession arising from transactions of an isolated nature, the following principle should be taken into account to ascertain whether the transaction is an adventure in the nature of trade:

- (i) The transaction is said to be in the nature of trade only if some of the elements of trade are found in the transaction, the most important being the object of making profit. It is not essential that all the activities following the main object of the business and which constitute separate transactions by themselves must be entered into with the idea of making profit. In other words, a person whose object is to carry on a business may indulge in certain transactions knowing fully well that he would have to incur loss although he may derive income from the others (e.g. the case of dealer in shares).
- (ii) The purchase of an asset or property with the intention to resell the same may be one of the vital factors in determining the nature of the transaction but the intention to resell at a profit is not to be taken as the only factor for this purpose. This is because of the fact that the cases where the assessee has no intention of enjoying or holding the property, there would be a strong presumption that the transaction is in the nature of trade although this presumption may be rebuttable in certain circumstances depending upon the facts of the case.
- (iii) It is, however, not possible to evolve a common test or formula which could be applied uniformly in all cases to determine whether a particular transaction is an adventure in the nature of trade or not. The nature of the transaction will have to be determined in each case depending upon the facts or circumstances. The concept of income based upon the principles discussed under Section 4 laying down the principles to be applied for distinguishing between receipts of a capital and revenue nature must be followed even in cases where income is to be computed under this head. In other words, the taxability of income under this head depends primarily upon the fact that the receipt in question is of a revenue nature and is consequently assessable as income under the Act. However, there are a few cases where capital receipts are also chargeable to tax as income from business as has been explained in the next pages.

Test Your Knowledge



1. The expression 'Profession' has been defined in Section 2(36) of the Act to include any
- Idea
 - Vocation
 - Business
 - Purchase

INCOME CHARGEABLE TO INCOME-TAX (SECTION 28)

The scope of income chargeable under the head 'Profits and Gains from business or Profession' is covered by Section 28 of the Act which lays down that the following items of income must be charged to tax under this head:

- The profits and gains of any business or profession which was carried on by the assessee at any time during the previous year.
- (a) Any compensation or other payment due to or received by any person (by whatever name called) managing the whole or substantially the whole of the affairs of an Indian Company, at or in connection with the termination of his management or the modification of the terms and conditions relating thereto.
(b) Any compensation or other payment due to or received by any person, by whatever name called, holding an agency in India for any part of the activities relating to the business of any other person at or in connection with the termination of the agency or the modification of the terms and conditions relating thereto.
(c) Any compensation or other payment due to or received by any person for or in connection with the vesting in the Government or any corporation owned or controlled by the Government under any law for the time being in force of the management of any property or business;

The three items of compensation for termination of a managing agency or other agency specified above constitute an exception to the rule that capital receipts are not normally treated as income for the purposes of taxation. But the fact that these compensations are taxable as business income does not in any way alter the character of the receipt which is of a capital nature. This is because of the fact that compensation received for termination of an agency is in replacement of the source of income itself and thus constitutes a capital receipt.

- Any income derived by a trade or professional or other similar association from the specific services performed by it for its members.

Trade association means an association of businessmen for the protection and advancement of their common interest e.g. a Chamber of Commerce. Section 28(iii) does not apply to other social associations e.g. a sports club or cricket club etc. Similarly the income of a charitable trust from specific services rendered to its members is not assessable under Section 28(iii) but exempted under Section 11 [C.I.T. v. South Indian Film Chamber of Commerce (1981) 129 I.T.R. p. 22 (Mad.)].

According to the general principles of mutuality and the principle that no one can make a profit out of himself, mutual associations or bodies are exempt from income-tax in respect of the net results of the transactions with their own members. These exemptions generally apply to associations like

Chambers of Commerce, Seller's Associations, Buyer's Associations, Stock Broker's Associations, etc. But according to Clause (iii) of Section 28 which constitutes an exception to the principle of mutuality, any income derived by a trade or professional association by rendering specific services to any of its members would constitute income from business chargeable to tax under this head. Thus a Chamber of Commerce providing lodging facilities to its members would be chargeable to income-tax under this head in respect of the charges, if any, by way of fees or other payment collected from the members for rendering such specific services. The services, the income from which is chargeable to tax, may be those which are rendered in the normal course of the activities of the association or may be outside the scope of such normal activities. If, however, the income is derived as a part of usual contributions or subscriptions and not for the purpose of rendering any specific services to the members concerned, the trade or professional association would not attract liability to tax under this head.

In the case of any persons carrying on a profession, the value of any benefit or perquisite arising to them from the exercise of their profession would be chargeable to tax irrespective of the fact whether such perquisite or benefit is convertible into money or not. For instance, an advocate who in the course of rendering services to his clients at a place other than his normal place of professional work gets any other benefit at the expense of the client, he would be chargeable to tax in respect of that amount too. If the recipient of the benefit or perquisite is an employee of the person from whom the benefit is derived, the value of the perquisite would be chargeable to tax as income from salaries under Section 15 but not as income from business. The provision covers only those cases where the value of the benefit is not taxable under the head salaries and the person deriving the benefit is carrying on a business or profession.

(iv) Export Incentives:

- (a) Profits on sale of a licence granted under the Imports (Control) Order, 1955, made under the Imports and Exports (Control) Act, 1947;
- (b) Cash assistance (by whatever name called) received or receivable by any person against exports under any scheme of the Government of India;
- (c) Any duty of customs or excise re-paid or re-payable as drawback to any person against exports under the Customs and Central Excise Duties Drawback Rules, 1995, or any profit on transfer of the Duty Entitlement Pass Book Scheme, or any profit on the transfer of the Duty Free Replenishment Certificate.
- (v) The value of any benefit or perquisite, whether convertible into money or not, which arises from the carrying on of a business or the exercise of a profession.
- (vi) Any interest, salary, bonus, commission or remuneration, by whatever name called, due to or received by a partner of a firm from such firm.

However, where any interest, salary, bonus, commission or remuneration or any part thereof has not been allowed to be deducted under Section 40(b), the income under this clause shall be adjusted to the extent of the amount not so allowed to be deducted.

(vii) any sum, whether received or receivable in cash or kind, under an agreement for –

- (a) not carrying out any activity in relation to any business or
- (b) not sharing any know-how, patent, copyright, trade mark, licence, franchise or any other business or commercial right of similar nature or information or technique likely to assist in the manufacture or processing of goods or provision of services:

Provided that Sub-clause (a) shall not apply to –

- (i) any sum, whether received or receivable, in cash or kind, on account of transfer of the right to manufacture, produce or process any article or thing or right to carry on any business, which is chargeable under the head "Capital Gains";
- (ii) any sum received as compensation, from the multilateral fund of the Montreal Protocol on substances that deplete the Ozone layer under the United Nations Environment Programme, in accordance with the terms of agreement entered into with the Government of India.

Explanation : For the purposes of this clause –

- (i) "agreement" includes any arrangement or understanding or action in concert;
 - (A) whether or not such arrangement, understanding or action is formal or in writing; or
 - (B) whether or not such arrangement, understanding or action is intended to be enforceable by legal proceedings;
- (ii) "service" means service of any description which is made available to potential users and includes the provision of services in connection with business of any industrial or commercial nature such as accounting, banking, communication, conveying of news or information, advertising, entertainment, amusement, education, financing, insurance, chit funds, real estate, construction, transport, storage, processing, supply of electrical or other energy, boarding and lodging.
- (viii) Any sum received under a keyman Insurance Policy including the sum allocated by way of bonus on such policy.

Explanation: For the purpose of this clause, the expression "Keyman Insurance Policy" shall have the following meaning:

"Life Insurance Policy taken by a person on the life of another person who is or was the employee of the first mentioned person or is or was connected in any manner whatsoever with the business of the first mentioned person.

- (ix) any sum, whether received or receivable, in cash or kind, on account of any capital asset (other than land or goodwill or financial instrument) being demolished, destroyed, discarded or transferred, if the whole of the expenditure on such capital asset has been allowed as a deduction under section 35AD.

POINTS FOR CONSIDERATION WHILE COMPUTING INCOME UNDER THE HEAD BUSINESS OR PROFESSION

The provisions of the Income-tax Act contained in Sections 28 to 44DB regulate the method of computing income from business.

The income from business to which a person is chargeable under this head represents not the gross receipts from the business but the profits and gains derived from there. For instance, in the case of a businessman, the gross sale proceeds would not be the basis for levying tax but it is net profit or the profit or gain as determined in accordance with sections 28 to 44DB.

Method of Accounting (Section 145)

The profits and gains of a business are to be computed in accordance with the method of accounting regularly and consistently followed by the assessee or the method of accounting followed is such that income, profits or gains cannot properly be ascertained therefrom, the income-tax authorities are entitled to compute the income of the assessee on such basis and in such manner as they deem fit.

An assessee, for the purpose of his business, may follow the cash system of accounting or the mercantile system of accounting. Both these methods are well recognised for income-tax purposes and the tax authorities are bound by the method adopted by the assessee. The tax authorities are not also empowered to reject the method of accounting regularly followed by the assessee for the purpose of his business except, however, in cases where the method is not correct, complete or scientific.

An assessee may also follow the hybrid system of accounting for his business or profession. The hybrid system is the combination of the cash system and the mercantile system. This is mostly done in the case of professional men who follow cash system for their receipts and mercantile system for their payments.

Income earned in Cash or in Kind

The income that is chargeable to tax under this head may be realised by the assessee in cash or kind. In cases where the profit is realised in any other form than cash, the market value of the commodity received as income should be taken to be the quantum of income chargeable to tax. Even in cases where an assessee is in receipt of money from his clients or other persons who are under no obligation to make such payment, the assessee would still be chargeable to tax if these monies were received by him in the ordinary course of business or profession. For instance, any amount paid to a Chartered Accountant by a person who has not been his client but who has been benefitted by his professional service to another, would be assessable as the Chartered Accountant's income from profession.

The person carrying on the business or profession would be chargeable to tax under this head regardless of the fact that the profits or gains made by him ultimately go to the benefit of some other person or to the business community or public body as a whole. In other words, the subsequent application of the money derived by way of income from business is immaterial for the purpose of assessment of the businessman.

Continuation of Business or Profession

The chargeability to tax under Section 28 is based primarily upon the condition that the assessee must have carried on a business or profession at any time during the accounting year, though not necessarily throughout the accounting year.

But there may be a few cases (e.g. deemed profits taxable under Section 41) where even if no business is carried on during the accounting year, the assessee would still be chargeable to tax.

Ownership of Business is not Necessary for Taxability

In order to be taxable in respect of the income of a business it is not essential that the business must be carried on by the same person who is the owner thereof. Even if the owner authorises some other person to carry on the business on his behalf or the owner is deprived by the court under certain circumstances of the right to carry on his own business, the owner will still be taxable under this head.

Similarly, it is not only the legal ownership but also the beneficial ownership that has to be considered. In this connection it has to be kept in view, as to who is the actual recipient of the income which is going to be taxed. For example, where a business is acquired for the benefit of a company which is going to be incorporated and the promoters carry on the business and earn profits during the period prior to the incorporation, if the company accepts the action of the promoters and receives from them the past profits made prior to its incorporation, the company shall be assessable under this section in respect of such profits although before the incorporation of the company the promoters were the legal owners of this business yet as the company was the beneficial owner (as it has actually received the profits) of the business, it will be assessable on these profits. [*CIT v. Biji Cotton Mills Ltd.* (1953) 23 ITR p. 278].

The tax is leviable on the person to whom the profits accrue or by whom the profits are received. No tax can be levied on a benamidar in whose name the business transactions are effected and who is not really entitled to the profits. [*C.I.T. v. Thaver Bros.* (1934) 2 ITR p. 230].

Business may be Legal or Illegal

While profit motive is indicative of and is not the sole test for determination of the fact that the adventure of an assessee is in the nature of trade and consequently constitutes a business, it is immaterial whether the business is legal or illegal.

In other words, the taxability of the income from business does not in any way depend upon or is affected by the taint of illegality in the income or the sources. Income derived from illegal activities is as much chargeable to tax as income from other operations. The fact that the person who carried on the illegal activities is punishable under the appropriate law, does not exclude him from the liability to income-tax. However, the loss arising directly in the course of an illegal business is deductible as business expenditure in computing the profits from that business. [C.I.T. v. S.C. Kothari (1971) 82 I.T.R. p. 794 (S.C.) and C.I.T. v. Piara Singh (1980) 124 I.T.R. p. 40 (S.C.)].

Profit Motive is not the Sole Consideration for Taxability

There may be assessees who carry on business without the primary object of making profits (e.g., a co-operative society which tries to cater to the needs of its members without the object of making maximum profits). Even in such cases, if profits arise from the business carried on by the assessee and such profits are incidental to the business, the assessee would still be taxable. Therefore, profit motive is not the only test of determining the taxability of income from any activity constituting business or profession.

Computation of Income Separately for each Business

A taxpayer is entitled to carry on as much number of businesses as he can, both in his own name and in the name of others. The profits and gains of all businesses or professions would be assessable under this head. But the profit of each business must be computed separately from one another and the deductions and allowance permissible to each business must be allowed against the income derived therefrom. The income chargeable under this head is the aggregate of the net result of the various business or businesses or profession(s) carried on during the accounting year. Thus, the loss arising from one business would be set off against income from another business falling under the same head and the net result after such set off would alone be assessable income under this head. The law does not permit an assessee to club all the sources of his income under the head and claim a composite amount towards expenses and losses attributable to all the businesses. If an assessee has incurred an item of expenditure for the purpose of many businesses the expenditure in question will have to be apportioned against each business for the purpose of allowance.

PROFITS AND LOSSES OF SPECULATION BUSINESS

The term speculation has not been exhaustively defined in the income-tax Act, but it normally denotes the meaning commonly assigned to it in commercial practice. However, Section 43(5) defines the expression "speculative transaction" as "a transaction in which a contract for the purchase or sale of any commodity including stocks and shares is periodically or ultimately settled otherwise than by the actual delivery or transfer of the commodity or scrips". Where a company (other than banking or financial company) deals in shares of other companies, the income from such business is treated as income from speculative business.

Transactions not considered as speculative transactions

However, the following four forms of transactions have been specifically excluded from the scope of speculative transactions:

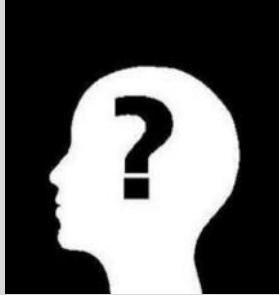
- (i) A contract in respect of raw-materials or merchandise entered into by a person in the course of his manufacturing or merchanting business to guard against loss through future price fluctuations in respect of his contracts for actual delivery of goods manufactured by him or merchandise sold by him; or
- (ii) A contract in respect of stocks and shares entered into by a dealer or investor therein to guard against loss in his holdings of stocks and shares through price fluctuations; or
- (iii) A contract entered into by a member of a forward market or a stock exchange in the course of any transaction which is in the nature of jobbing or arbitrage to guard against any loss which may arise in the ordinary course of his business as such member.

- (iv) An eligible transaction in respect of trading in derivatives referred to in Clause (aa) of Section 2 of the Securities Contracts (Regulation) Act, 1956 carried out in a recognized stock exchange.

Therefore, in all cases where actual delivery or transfer of the commodity takes place, the transaction would not be a speculative transaction, however highly speculative its nature may be.

The above-mentioned four items constitute exceptions provided by the Act whereby transactions such as hedging contracts entered into by manufacturer and merchants in the course of their business to guard against the losses through price fluctuations are excluded from the definition of speculative transactions.

Test Your Knowledge



2. Transactions such as hedging contracts entered into by manufacturer and merchants in the course of their business to guard against the losses through price fluctuations are included in speculative transactions.

- (a) True
- (b) False

Computation of Profits of Business or Profession

The profits and gains of business or profession are computed in accordance with the provisions contained in Sections 30 to 43D. Sections 30 to 37 contain those deductions which are expressly allowed while computing profits of business or profession. Section 40 provides those expenses which are allowed on the basis of general commercial principles while computing profits of business or profession. It is necessary to know those principles before studying the deductions expressly allowed while computing profits of business or profession.

The general commercial principles are as under:

- (1) Profits should be computed according to the method of accounting regularly employed by the assessee, provided that actual profit can be ascertained by this method, whether on receipt basis or accrual basis.
- (2) Only those expenses and losses are allowed as deductions which were incurred or sustained during the relevant previous year and related to business.
- (3) These losses and expenses should be incidental to the operation of the business. For example, embezzlement by an employee during the course of business is a loss incidental to the business. Similarly, loss from dacoity in a bank is also a loss incidental to the business of a bank.
- (4) If a business has been discontinued before the commencement of the previous year, its expenses cannot be allowed as deduction against the income of any other running business of the assessee.
- (5) There are some essential expenses, though neither expressly allowed nor disallowed, but are deductible while computing the profits of business or profession on the basis of general commercial principles provided that these are not expenses or losses of a capital nature or personal nature.
- (6) Any expenditure incurred in consideration of commercial expediency is allowed as deduction.
- (7) Deduction can be made from the income of that business only for which the expenses were incurred. The expenses of one business cannot be charged against the income of any other business.

Computation of Income under the head “Profits and Gains from Business or Profession”

Profit as per P&L A/c
 Add:

- (i) Expenses or losses disallowed but charged in P&L A/c
- (ii) Incomes taxable as business income but not credited to the P&L A/c
- (iii) Expenses in excess of the allowed amount charged in P&L A/c
- (iv) Undervaluation of closing stock or overvaluation of opening stock.

Deduct:

- (i) Expenses or losses allowed but not debited to P&L A/c
- (ii) Incomes not taxable as business income but credited to the P&L A/c
- (iii) Incomes exempt from tax but credited in P&L A/c
- (iv) Overvaluation of closing stock and undervaluation of opening stock.

Taxable Income from Business or Profession

DEDUCTIONS ALLOWABLE

(A) Rent, Rates, Taxes, Repairs and Insurance for Buildings (Section 30)

In respect of the business premises used by the assessee, the deduction is available in computing the income from business for the following items :

- (a) Where the premises are occupied by the assessee in his capacity as tenant, the rent paid for such premises would be deductible. In cases where the assessee has also undertaken to bear the cost of repairs as part of the terms of his tenancy agreement, the amount of expenses actually incurred by him on account of repairs would also be deductible.
- (b) If the assessee occupies premises not in the capacity of a tenant but as its owner, a lessee or licensee, the expenses incurred on current repairs to the premises would be deductible.
- (c) The assessee is also entitled to deduct any amount paid by him on account of land revenue, local rates or municipal taxes in respect of the premises.

Explanation. – For the removal of doubts, it is hereby declared that the amount paid on account of the cost of repairs referred to in sub-clause (i), and the amount paid on account of current repairs referred to in sub-clause (ii), of clause (a), shall not include any expenditure in the nature of capital expenditure.”

- (d) Any premium paid in respect of insurance against risk of damage or destruction of the premises, is also deductible.

Deduction of expenses on the basis of usage:

Section 38 of the Act provides for the allowance of the proportionate amount of the expenses in this regard. It is possible that an assessee who has taken a building on rent for business purposes may sublet a part of the same. In such cases, the deduction allowable under the section would be a sum equal to the difference between the rent paid by the assessee and the rent recovered from the sub-tenant. The allowability of rent payable in respect of business premises does not in any way depend upon the taxability or otherwise of the rental income in the hands of the owner of the building. If the assessee is the owner of the building which is used for business or professional purposes, no deduction would be available in respect of the notional rent which would otherwise have been payable. But depreciation under Section 32 would be available in respect of such buildings. In cases

where a firm carries on a business in the premises owned by one of its partners the rent payable to the partner would be an allowable deduction since the firm and the partners are separate entities.

In cases where the assessee uses the premises partly for his business or professional purposes and partly for other purposes the deduction allowable under this section is a sum proportionate to that part of the expenses which are attributable to the premises used for business or professional purposes.

(B) Repairs and Insurance of Machinery, Plant and Furniture (Section 31)

- Income from business or profession should be computed after allowing deductions under Section 31 in respect of repairs and insurance of the machinery, plant or furniture used for the purpose of business or profession. The deduction allowable would cover the amount of expenses on account of current repairs and also the amount of any premium paid in respect of insurance of the machinery, plant or furniture against any risk of damage or destruction thereof.
- The assessee is entitled for deduction in respect of repairs and insurance of these assets only if these assets have been actually used for the purpose of the business of the assessee during the accounting year the profits of which are subjected to tax. Thus, if the assets are used in some business, income of which is not chargeable to tax, the assessee cannot claim deduction in respect of these expenses against the income from some other business, the profits of which are taxable.
- It is not essential that the assessee must be the owner of these assets in order to claim deduction in respect of these expenses. Even if these assets have been taken on hire, the assessee would still be entitled for the deduction.
- On the other hand, if the assessee is the owner of the machinery, plant or furniture and these assets are held as the assets of the business but have not been made use of for the purposes of the business during the accounting year, no deduction would be available. But the allowance of these expenses does not in any way get affected by the fact that these assets are used only for a part of the accounting year in the business of the assessee.
- The allowance for repairs covers not only the expenses of ordinary maintenance and replacement of the small parts but also of the renewal or renovation of the asset.
- However, the expenses incurred towards replacement or reconditioning of the machinery or plant or furniture, would not be allowable under this section because the cost of replacement or reconditioning of an asset would be an expenditure of a capital nature since it results in the acquisition of a capital asset or benefit of an enduring nature.

In cases where the assessee incurs expenses in respect of repairs of the plant and machinery of a large sum in one year and these repairs relate to a number of years which have not been actually carried out, the deduction allowable under this section would be only in respect of the expenses on current repairs although the expenses in regard to arrears of repairs may be deductible under Section 37(1).

- The simple test that must be constantly borne in mind is that as a result of the expenditure which is claimed as an expenditure for repairs, what is really being done is to preserve and maintain an already existing asset. The object of the expenditure is neither to bring a new asset in to existence, nor to obtain any fresh advantage. [New Shorrock Spinning and Manufacturing Co. Ltd. v. C.I.T. (1956) 30 I.T.R. p. 338]. The replacement of the old diesel engine by a new engine in a motor van used for business purposes was done with a view to preserve and maintain the asset in existence and, as no enduring benefit was derived by the assessee, the expenditure was allowed. [Nathmal Bankat Lal Parikh and Company v. C.I.T. (1980) 122 I.T.R. p. 168].

(C) Depreciation (Section 32)

In computing income from business, one of the most important items of allowances is the allowance for depreciation provided by Section 32 of the Income-tax Act. The deduction towards depreciation is very essential to arrive at the income of the assessee and also to amortise the capital cost of the amount invested in buildings, machinery, plant and furniture. The purpose of allowing depreciation is to provide in course of time for the replacement of asset with the help of the capital cost of the asset which is allowed to be amortised over a period of time. The provisions for allowing depreciation are contained in Section 32 and are regulated under Rule 5 of the Income-tax Rules. The rates of depreciation are also provided in the Income-tax Rules.

Conditions for allowability of Depreciation

In order that the depreciation is allowable, the following conditions must be fulfilled:

(a) Classification of Assets:

The assets in respect of which depreciation is claimed must be buildings, machinery, plant or furniture. In addition to these tangible assets intangible assets like know how, patent rights, copy rights, trade marks, licences, franchises or any other business or commercial right of similar nature acquired on or after 1.4.1998 are eligible for depreciation. These intangible assets will form a separate block of assets. As and when any capital expenditure is incurred by an assessee on acquiring such intangible assets, the amount of such expenditure will be added to the block of intangible assets and depreciation will be claimed on the written down value at the end of financial year. While taking into account the depreciation allowance in respect of a building, only the cost of the building is to be taken into account but not the cost of the land on which the building is erected because the land does not suffer any depreciation as a result of wear and tear or its usage. Thus, the term building used in this context refers only to the super- structure and not the land on which it is erected [*C.I.T. v. Alps Theatre (1967) 65 I.T.R. p. 377 (S.C.)*]. Roads within a factory compound form part of building which is used for the purpose of the business and as such are entitled to depreciation. Similarly, residential quarters provided to the employees are used for the business in the sense that they are used for and such user is incidental to the carrying on the business. Therefore, the roads to such residential quarters are also entitled to depreciation at the rates applicable to first class building [*C.I.T. v. Kalyani Spinning Mills Ltd. (1981) 128 I.T.R. p. 279 (Cal.)*]. However, the M.P. High Court has held that expenditure incurred on construction of metal roads for approach to trenches to dump the waste and night soil, is capital expenditure. Moreover, such roads are not plant and machinery. Hence, the assessee is not entitled to depreciation on the cost of the metal roads [*Indore Municipal Corporation v. C.I.T. (1981) 132 I.T.R. p. 540 (MP)*].

Plant

The term 'plant' for the purpose of allowance of depreciation has been defined in Section 43(3) to include ships, vehicles, books, scientific apparatus and surgical equipments used for the purposes of the business or profession. However, on the basis of cases decided by the courts, the following are also included in the term 'plant':

- (i) In the case of a hotel, pipe and sanitary fittings [*C.I.T. v. Taj Mahal Hotel (1971) 82 I.T.R. p. 44 (S.C.)*].
- (ii) In the case of electric supply company, mains service lines and switch gears [*C.I.T. v. Warner Hindustan Limited*].
- (iii) Well.
- (iv) In the case of manufacturer of oxygen, gas-cylinder for storing gas.
- (v) Technical know-how in the form of blue prints, instruction, technical manuals. [*C.I.T. v. Festo Elgi Pvt. Ltd. (1981) 129 I.T.R. p. 499*].

- (vi) Thermocole insulation. [C.I.T. v. Yamuna Cold Storage (1981) 129 I.T.R. p. 728 (P.&H.)].
- (vii) New Coils. [Panipat Co-operative Sugar Mills Ltd. v. C.I.T. (1981) 129 I.T.R. p. 73 (P.&H.)].
- (viii) Data Processing Machines. [C.I.T. v. I.B.M. World Trade Corporation (1981) 130 I.T.R. p. 739 (Bom.)].

Since the definition of plant is inclusive in nature, it should be taken to cover all goods and chattels, whether fixed or moveable which a businessman may keep for the purpose of employment in his business with some degree of certainty and duration of time.

However, following are some of the instances which are not held as plant:

1. Warehouses for storage purposes
2. Horses
3. Human body
4. Bed of River
5. Water storage tanks used for storing water by the supplier for irrigation purposes.
6. Cinema Theaters
7. Hotel Building

Moreover, 'tea bushes', 'livestock', buildings or furniture and fittings have been excluded from the definition of plant w.e.f. assessment year 1962-63.

(b) Ownership Vs. lease:

Depreciation is allowable to the assessee only in respect of those capital assets which are owned by him. In case of a building, the assessee must be owner of the super-structure and not necessarily of the land on which it is constructed. If the assessee is only a tenant of the building but not its owner he is not entitled for allowance in respect of depreciation thereof. Where the land on which the building is constructed has been taken on lease by the assessee, the allowance of depreciation would be admissible only if, according to the lease deed, the assessee is entitled to be the owner of the super-structure. The fact that as part of the terms of the lease deed, the building, after expiry of the lease is to be transferred to the lessor of the land would not affect the allowance for depreciation.

In the case of assets acquired on hire-purchase e.g., plant and machinery taken on hire, the assessee would not be the owner thereof and consequently would not be entitled for depreciation in respect of the same. But if the plant and machinery had been acquired on instalment basis, the assessee becomes the owner of the assets the moment the purchase or sale is concluded and consequently is entitled to depreciation although a part or whole of the price is payable in future.

(c) Used for the purpose of Business or Profession:

The allowance for depreciation is subject to the condition that the assets on which depreciation is claimed are actually used by the assessee for the purposes of his business or profession during the accounting year. The allowance for depreciation, however, is not subject to the condition that the asset in question must be used throughout the relevant accounting year in order to enable the assessee to claim depreciation. Thus, even if the asset is used for a very small fraction of the accounting year, the assessee would be entitled to depreciation in respect of the full amount allowable as if the asset had been used throughout the accounting year. Even in the case of seasonal factories (e.g., sugar manufacturing companies), the full amount of depreciation is allowable if the asset had been used at any time during the accounting year in the factory. In cases where the depreciable asset is used partly for business purposes and partly for other purposes, the deduction towards depreciation allowable under Section 32 would be of a sum proportionate to the depreciation allowance to which the assessee would have otherwise been entitled, in the year in

which the depreciable asset is sold, destroyed, discarded or demolished, no depreciation at the rates prescribed in the Income-tax Rules would be allowable.

- (d) **Amount of deduction shall not exceed actual cost:** The total amount of all items of depreciation allowance allowed to the assessee from year to year shall not exceed the actual cost of the block of assets to the assessee.
- (e) **No deduction on sold assets:** No depreciation is allowable in respect of the depreciable asset if the asset concerned is sold, destroyed, discarded or demolished in the same year in which it was acquired.
- (f) In order to be entitled to allowance towards depreciation, the assessee must furnish the prescribed particulars contained in Annexure 'B' attached to the Form of the Return of Income-tax. Any failure on the part of the assessee to furnish fully and truly all material facts, including the particulars prescribed for this purpose, would entitle the income-tax authorities to refuse to allow deduction towards depreciation.
- (g) The Finance Act, 1995 has deleted w.e.f. assessment year 1996-97 the provision pursuant to which one could write off the entire cost of plant and machinery in the very first previous year in which it was put to use provided its actual cost did not exceed ₹ 5,000, to prevent the widespread misuse of the concession.
- (h) The Finance (No. 2) Act, 1996 has rationalised the depreciation provisions, *inter alia* as follows:

In case of joint ownership of an asset, depreciation would be allowed to each of the owner in proportion to the contribution to the total cost of the asset; and

In case of amalgamation during the course of a previous year, the amalgamating company and the amalgamated company shall share the depreciation in proportion to the number of days during which the assets remained under their respective ownership.

Similarly, in case of demerger during the course of a previous year (w.e.f. 1.4.2000), the demerged company and the resulting company shall share the depreciation in proportion to the number of days during which the assets remained under their respective ownership.

Meaning of Block of Assets

The depreciation is provided in respect of "Block of assets". As per Section 2(11) Block of assets means "*a group of assets falling within a class of assets, being tangible assets such as buildings, machinery, plant or furniture and intangible assets, being know-how, patents, copyrights, trademarks, licences, Franchises or any other business or commercial rights of similar nature, in respect of which the same percentage of depreciation is prescribed*".

Moreover depreciation is now allowed on the written down value of all types of assets. Again, no deduction shall be allowed under this clause in respect of any motor car manufactured outside India, where such motor car is acquired by the assessee after the 28th day of February, 1975, and is used otherwise than in a business of running it on hire for tourists or,

- (a) outside India in his business or profession in another country, and
- (b) in respect of any machinery or plant if the actual cost thereof is allowed as a deduction in one or more years under an agreement entered into by the Central Government under Section 42 of the Act.

Important Terms

For the purposes of depreciation, the following terms are important:

- (i) Actual Cost
- (ii) Written Down Value
- (iii) Classification of Depreciation

(i) Actual Cost [Section 43(1)]

For computing depreciation, actual cost is the basis in the case of all assets for the first year when the assets are put to use for the purpose of the business. Subsequently, even in the case of depreciable asset when the written down value is to be ascertained for the purpose of allowing depreciation, the written down value should be taken to be the book value of the asset after allowing deduction in respect of the depreciation allowable under the Income-tax Act from the actual cost of the asset concerned. The actual cost of an asset is essential for the purposes of allowing depreciation also because of the fact that the aggregate of all the items of depreciation allowable to an assessee in respect of any depreciable asset shall not exceed the amount of its actual cost.

The actual cost of an asset to the assessee is normally the amount of capital expenditure incurred in respect of the acquisition, installation, etc., of the asset and also the expenses, if any, incurred by him to make the asset ready for the purpose of its use in the business. Thus, capital expenditure relating to the installation of machinery or plant, its design, etc., would form part of the actual cost of the machinery although such expenses may be incurred by the assessee subsequent to the date of its acquisition. It has been held that preliminary expenses of revenue nature necessary for putting plant and machinery in working condition are part of actual cost of plant and machinery. [*Shree Vallabh Glass Works Ltd. v. C.I.T. (1981) 127 I.T.R. p. 37 (Guj.)*]. However, if a factory of an assessee is shifted to new site, the expenses of shifting the depreciable asset or its installation would be capital expenses and would not form part of the actual cost, because no beneficial asset was acquired or improvement made in the capital assets. [*Sitalpur Sugar Works v. C.I.T. (1963) 49 I.T.R. p. 160 (S.C.)*]. Where a plant is constructed or acquired out of borrowed money by a newly started company, interest paid on the loan upto the date of commencement of production will be capitalised and treated as part of the actual cost of the plant on which depreciation and investment deposit benefits will be allowed. [*Challapali Sugar v. C.I.T. (1973) 98 I.T.R. p. 167 (S.C.)*]

Definition of Actual Cost

The expression 'actual cost' has been defined in Section 43(1) of the Act to mean that actual cost of the asset to the assessee as reduced by that portion of the cost thereof, if any, as has been met directly or indirectly by any other person or authority. For instance, if an assessee gets a subsidy from the Government for the purchase of a particular item of machinery, the actual cost of the machinery to the assessee would be total of the purchase price and the expenses in regard to installation etc. minus the subsidy received from the Government. However, where any amount has been received as compensation for low output of defective machinery, it will be a revenue receipt and assessed to tax but it will not be deducted in computing actual cost of machinery. [*C.I.T. v. Rohtas Industries Ltd. (1981) 130 I.T.R. p. 292 (Cal.)*]. Thus, the actual cost of the asset as shown in the books will be different from the actual cost on the basis of which depreciation is allowable.

The provisions of Section 43(1) of the Act clarify that the actual cost of depreciable asset should be determined in the following circumstances as indicated below:

(a) Assets used in business after it ceases to be used for Scientific Research

In cases where the depreciable asset is used for the business after it ceases to be used for scientific research related to that business and a deduction has been allowed in respect of expenditure on scientific research under Section 35, the actual cost of the asset to the assessee should be taken to be the original cost to the assessee minus the amount of any deduction under Section 35 of the Act, originally allowed.

Note: If capital expenditure for scientific research is incurred after 31-3-1967, the whole of such expenditure is deductible for the relevant previous year. Hence, the cost of such asset for depreciation purposes shall be nil.

(b) Assets acquired by way of gift or inheritance

In cases where the depreciable asset is acquired by the assessee by way of gift or inheritance, the actual cost of the asset to the assessee shall be the actual cost to the previous owner, as reduced by -

- (a) the amount of the depreciation actually allowed to the donor or predecessor in respect of any previous year relevant to the assessment year commencing before the 1st day of April, 1988, and
- (b) the amount of depreciation that would have been allowable to the assessee for any assessment year commencing on or after the 1st day of April, 1988, as if the asset was the only asset in the relevant block of assets.

In case where a portion of the cost of an asset is acquired by the assessee has been met directly or indirectly by the Central Government or State Government or any authority established under any law, or by any other person, in the form of subsidy or grant or reimbursement, then in case where the subsidy is directly relatable to the asset such subsidy shall not be included in the actual cost of the asset. In case where such subsidy or grant or reimbursement is of such a nature that it cannot be directly relatable to any particular asset, the amount so received shall be apportioned in a manner that such asset bears to all assets in respect of or with reference to which the subsidy or grant or reimbursement is so received and such subsidy shall not be included in the actual cost of the asset.

(c) Assets transferred to reduce tax liability

In cases where prior to the date of acquisition by the assessee the depreciable asset was at any time used by any other person for the purpose of his business or profession and the Assessing Officer is satisfied that the main purpose of the transfer of the asset directly or indirectly to the assessee was to secure a reduction of liability to income-tax by claiming depreciation with reference to the enhanced cost, the actual cost of the asset to the assessee should be taken at such amount as the Assessing Officer may, with the prior approval of the Deputy Commissioner, determine having due regard to all the circumstances of the case. For instance, if 'X' transfers his machinery on 1.1.1990 to 'Y' for a sum of ₹ 6.00 lakhs while the actual cost of the asset and the written down value thereof on that day to 'X' are ₹ 3.00 lakhs and ₹ 1.00 lakh respectively, it may be inferred that the transfer by 'X' to 'Y' is made with idea to enable 'Y' to claim depreciation on ₹ 6.00 Lakhs while the market value of the asset on the date of sale by 'X' to 'Y' may be ₹ 4.00 lakhs only. In such a case, the Assessing Officer would be entitled to allow depreciation to 'Y' on the basis of the cost which may be determined by him to be ₹ 4.00 lakhs instead of ₹ 6.00 lakhs as claimed by 'Y'.

(d) Assets earlier transferred re-acquired by the Assessee

There may be cases where depreciable asset would have once belonged to the assessee and had been used by him for the purposes of his business or profession and thereafter it might have ceased to be his property by reason of its transfer or otherwise. If such a depreciable asset is re-acquired by the assessee himself, the actual cost of the asset should be taken to be the least of either -

- (a) actual cost of the asset to the assessee when it was first acquired by him minus (i) the depreciation actually allowed to him in respect of any previous year relevant to the assessment year commencing before the 1st day of April, 1988, and (ii) the amount of depreciation that would have been allowable to the assessee for any assessment year commencing on or after the 1st day of April, 1988, as if the asset was the only asset in the relevant block of assets or.
- (b) the actual price for which the asset is re-acquired by him.

(e) Building brought into use for business purpose subsequent to its acquisition

In cases where a building which was previously the property of the assessee is brought into use for the purpose of his business or profession after 28-2-1946, the actual cost of the building to the assessee should be taken to be the original cost of the building minus the amount equal to the depreciation calculated at the rate in force at that date which would have been allowable had the building been used for purposes of the business or profession ever since the date of its acquisition by the assessee.

(f) Asset transferred by holding company to 100% subsidiary company or vice-versa

In cases where any depreciable asset is transferred by an Indian holding company to its wholly owned

subsidiary or vice versa, then the actual cost of the transferred asset to the transferee company shall be taken to be the same as it would have been if the transferor company had continued to hold the transferred capital asset for the purposes of its own business.

(g) Asset transferred under a Scheme of Amalgamation

In the case of an amalgamation as defined in Section 2(1B) of the Act, if any depreciable asset is transferred by the amalgamating company to the amalgamated company, which is an Indian company as defined in Section 2(26) of the Act, the actual cost of the transferred capital asset to the amalgamated company must be taken to be the same as it would have been if the amalgamating company had continued to hold the capital asset for the purposes of its own business.

(h) Asset transferred to the resulting company in case of demerger

In case of demerger, any capital asset is transferred by the demerged company to the resulting company and the resulting company is an Indian company, the actual cost of the transferred capital asset to the resulting company shall be taken to be the same as it would have been if the demerged company had continued to hold the capital asset for the purpose of its own business.

Provided that such actual cost shall not exceed the written down value of such capital asset in the hands of the demerged company.

(i) Interest Pertaining to Post Acquisition Period

Where any amount is paid or is payable as interest in connection with the acquisition of an asset, so much of such amount as is relatable to any period after such asset is first put to use shall not be included, and shall be deemed never to have been included, in the actual cost of such asset.

(j) Actual Cost of Cenvetabale Asset

Where an asset is or has been acquired on or after the 1st day of March, 1994 by an assessee, the actual cost of asset shall be reduced by the amount of duty of excise or the additional duty leviable under section 3 of the Customs Tariff Act, 1975 (51 of 1975) in respect of which a claim of credit has been made and allowed under the Central Excise Rules, 1944.

(k) Asset acquired where portion of cost met by some other person

Where a portion of the cost of an asset acquired by the assessee has been met directly or indirectly by the Central Government or a State Government or any authority established under any law or by any other person, in the form of a subsidy or grant or reimbursement (by whatever name called), then, so much of the cost as is relatable to such subsidy or grant or reimbursement shall not be included in the actual cost of the asset to the assessee :

Provided that where such subsidy or grant or reimbursement is of such nature that it cannot be directly relatable to the asset acquired, so much of the amount which bears to the total subsidy or reimbursement or grant the same proportion as such asset bears to all the assets in respect of or with reference to which the subsidy or grant or reimbursement is so received, shall not be included in the actual cost of the asset to the assessee.

(l) Asset acquired by non-resident outside India but for business or profession in India

Where an asset which was acquired outside India by an assessee, being a non-resident, is brought by him to India and used for the purposes of his business or profession, the actual cost of the asset to the assessee shall be the actual cost to the assessee, as reduced by an amount equal to the amount of depreciation calculated at the rate in force that would have been allowable had the asset been used in India for the said purposes since the date of its acquisition by the assessee.

(m) Asset acquired under scheme of corporatisation of Recognised Stock Exchange

Where any capital asset is acquired by the assessee under a scheme for corporatisation of a recognised stock exchange in India, approved by the Securities and Exchange Board of India established under section 3 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), the actual cost of the asset shall be deemed to be the amount which would have been regarded as actual cost had there been no such corporatization.

(n) Capital Asset on which deduction has been allowed or allowable u/s 35AD

The actual cost of any capital asset on which deduction has been allowed or is allowable to the assessee under section 35AD, shall be treated as nil:

- (a) in the case of such assessee; and
- (b) in any other case if the capital asset is acquired or received:
 - (i) by way of gift or will or an irrevocable trust;
 - (ii) on any distribution on liquidation of the company; and
 - (iii) by such mode of transfer as is referred to in clauses (i), (iv), (v), (vi), (vib), (xiii) and(xiv) of section 47.

Depreciation is not allowed in case of a foreign car acquired by the assessee after 28th day of February, 1975 and used otherwise than in a business of running it on hire for tourists or is not used outside India in business or profession carried on by the assessee in another country.

In cases where the assessee acquires the business of another, the original cost of the depreciable asset to the assessee would be the value at which assets are taken over by him and not the original cost of those assets to the previous owner of the business. However, in case of succession by inheritance or gift where the actual cost to the assessee is taken to be the actual cost to the previous owner as reduced by the amount of depreciation actually allowed under the Act. In cases of partition of a HUF, if depreciable assets are divided amongst the members thereof at a genuine valuation, the cost of the asset to the member who, after the partition, uses the asset for the purposes of his business should be taken to be the value at which he takes over the asset.

(ii) Written down value [Section 43(6)]

The written down means:

In the case of assets acquired in the previous year, the actual cost of the assets to the assessee.

In the case of assets acquired before the previous year the actual cost of the assets to the assessee less all depreciation actually allowed to him in that Previous Year.

In the case of any block of assets the written down value will be determined as under:

Total of written down value of all the assets falling within a block at the beginning of the previous year relevant to the assessment year
.....

Add: The actual cost of, any new assets falling in the block, acquired during the previous year
.....

Less: Moneys payable in respect of any asset, falling within that block which is sold, discarded, demolished or destroyed during the previous year together with the amount of scrap value in respect of any asset.

The amount of deduction cannot exceed the written down value as so increased
.....

Written down value for the assessment year

Less: Depreciation during the previous year relevant to the assessment year

Written down value at the beginning of the previous year relevant to the next assessment year

The addition/deduction as aforesaid may be made for calculating written down value for the concerned previous year.

The written down value of any block of assets may be reduced to nil in the following cases:

- (i) Where money receivable in respect of assets sold or otherwise transferred during the previous year plus the amount of scrap value is more than the written down value at the beginning of the previous year as increased by the actual cost of any new asset acquired.
- (ii) Where all the assets in the relevant block are transferred during the year.

Explanation 1: When in a case of succession in business or profession, an assessment is made on the successor [under Section 170(2)], the written-down value of any asset or block of assets is the amount which would have been taken as its written-down value if the assessment had been made directly on the person succeeded to.

Explanation 2: Where in any previous year, any block of assets is transferred:

- (a) by a holding company to its subsidiary company or by a subsidiary company to its holding company and the conditions of clause (iv) or, as the case may be, of clause (v) of Section 47 are satisfied; or
- (b) by the amalgamating company to the amalgamated company in a scheme of amalgamation, and the amalgamated company is an Indian Company, then, notwithstanding anything contained in clause (i), the actual cost of the block of assets in the case of the transferee company or the amalgamated company, as the case may be, shall be the written down value of the block of assets as in the case of the transferor company or the amalgamating company for the immediately preceding previous year as reduced by the amount of depreciation actually allowed in relation to the said preceding previous year.

Explanation 2A: Where in any previous year, any asset forming part of a block of asset is transferred by a demerged company to the resulting company then the written down value of the block of asset of the demerged company for the immediately preceding previous year shall be reduced by the written down value of the assets transferred to the resulting company pursuant to the demerger.

Explanation 2B: Where in a previous year, any asset forming part of a block of assets is transferred by a demerged company to the resulting company, then the written down value of the block of assets in the case of the resulting company shall be the written down value of the transferred assets of the demerged company immediately before the demerger. Provided that the value of the assets as appearing in the books of account of the demerged company immediately before the demerger exceeds the written down value of such assets in the hands of the demerged company, the amount representing such excess shall be reduced from the written down value of the assets.

Explanation 3: Any unabsorbed depreciation [under Section 32(2)] is deemed to be depreciation actually allowed.

Explanation 4: For the purposes of this clause, the expression "money payable" and "sold" shall have the same meaning as in the Explanation to Sub-section (4) of Section 41.

Explanation 5: For the removal of doubts, it is hereby declared that the provisions of this sub-section shall apply whether or not the assessee has claimed the deduction in respect of depreciation in computing his total income.

Explanation 6: Where an assessee was not required to compute his total income for the purposes of this Act for any previous year or years preceding the previous year relevant to the assessment year under consideration,

- (a) the actual cost of an asset shall be adjusted by the amount attributable to the revaluation of such asset, if any, in the books of account;
- (b) the total amount of depreciation on such asset, provided in the books of account of the assessee in respect of such previous year or years preceding the previous year relevant to the assessment year under consideration shall be deemed to be the depreciation actually allowed under this Act for the purposes of this clause; and
- (c) the depreciation actually allowed under clause (b) shall be adjusted by the amount of depreciation attributable to such revaluation of the asset.

Explanation 7: where the income of an assessee is derived, in part from agriculture and in part from business chargeable to income-tax under the head "Profits and gains of business or profession", for computing the written down value of assets acquired before the previous year, the total amount of depreciation shall be computed as if the entire income is derived from the business of the assessee under the head "Profits and gains of business or profession" and the depreciation so computed shall be deemed to be the depreciation actually allowed under this Act.

(iii) Classification of depreciation

(a) Normal Depreciation [Section 32(1) Rule 5]

Normal depreciation is calculated at the specified percentage on the written-down value of block of assets (including ocean going ships). Further, where any new machinery or plant is installed during the previous year for the purposes of manufacture or production of any article or thing, and such article or thing (a) is manufactured or produced by using any technology or know-how developed in, or (b) is invented in, a laboratory owned or financed by the Government or owned by a public sector company or university or a duly recognised institution, then such plant or machinery shall be treated as part of block of assets qualifying for depreciation @ 50% of written down value subject to the fulfillment of the following conditions:

- (i) the right to use such technology or know-how or to manufacture such article or thing has been acquired from the owner of the laboratory or from any person who has derived the right from such owner;
- (ii) the return furnished by the assessee for his income or the income of any other person for which he is assessable for any previous year in which the said machinery or plant is acquired is accompanied by a certificate from the prescribed authority (Secretary, Department of Scientific and Industrial Research, Government of India) to the effect that such technology or know-how is developed in, or the article or thing is invented in such laboratory; and
- (iii) the machinery or plant is not used for the purposes of business of manufacture or production of any article listed in the Eleventh Schedule (i.e. low priority articles).

For the purposes of above:

- (a) "laboratory financed by the Government" means a laboratory owned by any body (including a society registered under the Societies Registration Act, 1860 (21 of 1860), and financed wholly or mainly by the Government;
- (b) "public sector company" means any corporation established by or under any Central, State or Provincial Act or a Government company as defined in Section 617 of the Companies Act, 1956;
- (c) "University" means a University established or incorporated by or under a Central, State or Provincial Act and includes an institution declared under Section 3 of the University Grant Commission Act, 1956, to be a University for the purposes of that Act.

(b) Depreciation on Straight line basis

In the case of Power Units [Section 2(1)(i)] (optional to power generating units) From the assessment year

1998-99, an undertaking engaged in generation or generation and distribution of power can claim depreciation on straight line basis on the actual cost of individual asset. But the aggregate depreciation can not exceed the actual cost. Alternatively, such undertaking can claim depreciation, at its option, according to written down value method like any other assessee. The option for this purpose shall be exercised before the due date of furnishing return of income. Once this option is exercised, it shall be final and shall apply to all the subsequent years.

Terminal depreciation

If any asset, on which depreciation is claimed on basis of SLM, is sold and the amount by which money payable together with scrap value, fall short of WDV of such asset, depreciation shall be allowed equal to such deficiency in the year of sale.

Balancing Charge Section 41(2)

If any asset, on which depreciation is claimed on basis of SLM, asset is sold and the amount by which moneys payable together with scrap value, exceeds WDV of such asset, then the least of the following shall be taxable under the head PGBP.

- (i) difference between the actual cost and WDV
- (ii) difference between aggregate of moneys payable and WDV

(c) Additional Depreciation [Section 32(1)(iia)]

With effect from Assessment year 2006-07 existing clause (iia) has been substituted by new Clause (iia) to provide additional depreciation in certain circumstances. The additional depreciation shall be allowed @20% of the actual cost. The conditions and restrictions imposed by this provision are as under:

Under this clause the additional depreciation is available to assessee engaged in the business of manufacture or production of any article or thing or engaged in the business of generation or generation and distribution of power at the rate of 20% of actual cost of eligible new machinery or plant (other than ships and aircrafts acquired and installed in a previous year. Additional depreciation shall not be allowed if -

- (a) any machinery or plant which, before its installation by the assessee, was used either within or outside India by any other person; or
- (b) any machinery or plant installed in any office premises or any residential accommodation, including accommodation in the nature of a guest house; or
- (c) any office appliances or road transport vehicles; or
- (d) any machinery or plant, the whole of the actual cost of which is allowed as a deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and gains of business or profession" of any one previous year.

(iv) Calculation of Written Down Value of a block of asset [Section 43(6)]

- (a) Find out the written down value on the first day of the previous year (WDV) relevant to the assessment year, of all those depreciable assets on which the depreciation is allowed at the same rate. All such assets are known as "block assets".
- (b) The increase in the WDV by the actual cost of any asset falling within that block, acquired during the previous year;
- (c) Reduce from the above, the moneys payable in respect of any asset falling within that block, which is sold or discarded or demolished or destroyed during that previous year together with the amount of the scrap value, if any, so that the amount of such reduction does not exceed the written down value as so increased; and

- (d) In the case of a slump sale, decrease by the actual cost of the asset falling within the block as reduced by the amount of depreciation that would have been allowable to the assessee for any assessment year, so that the amount of such decrease does not exceed the written down value.

It means if the net consideration of an asset out of the block is less than the balance under (ii), there would be no capital gain. If the net consideration of an asset is more than the balance under (ii) (the value of all assets in the block) the excess shall be deemed to be short term capital gain. If all the assets of the block are sold in the previous year and the net consideration is less than the balance under (ii), the loss shall be deemed to be short-term capital loss.

Where any capital asset is acquired by the assessee under a scheme for corporatisation of a recognised stock exchange in India, approved by the Securities and Exchange Board of India established under Section 3 of the Securities and Exchange Board of India, 1992 (15 of 1992), the actual cost of the asset shall be deemed to be the amount which would have been regarded as actual cost had there been no such corporatisation.

This may be easily followed by the following example:

Depreciable assets on 1.4.2012 on which the depreciation is available at the same rate of 25%.

Asset A	3,00,000
Asset B	5,00,000
Asset C	7,00,000
Total	15,00,000
Less: [Depreciation @ 25% of 15,00,000]	(3,75,000)
(i) Written down value on 1.4.2013 of block of assets	11,25,000
Add: Cost of Asset purchased during 2013-14	6,00,000
(ii) Balance	17,25,000
Asset B sold during year 2013-14	(6,75,000)
(iii) Balance	10,50,000
Less: Depreciation for 2013-14 @ 25%	
of ₹ 10,50,000	(2,62,500)
Written down value of all assets on 1.4.2014	7,87,500

Treatment of Depreciation in the case of Succession, Amalgamation & Demerger

The fifth proviso to Section 32(1) provides that in cases of succession in business or profession, in the case of amalgamation of companies or in the case of demerger of companies depreciation of plant and machinery, buildings and furniture in any previous year shall not exceed the depreciation calculated at the prescribed rate as if the succession, amalgamation or demerger had not taken place. It also seeks to allow the deduction to the predecessor and the successor or the amalgamating company and the amalgamated company or the demerged company and the resulting company in the same proportion as the number of days for which they used the asset in the business or profession.

Section 38(2) provides that where any building, machinery, plant or furniture is not exclusively used for the purposes of the business or profession, the deduction under Sections 30(a) & (c), 31(i) & (ii) and 32(1)(ii) shall be restricted to a fair proportionate part thereof as may be determined by the Assessing Officer.

This section has not been amended to cover Section 32(1)(i) under which depreciation to electricity undertaking is allowed. Hence, the depreciation for electricity, undertakings claiming deduction under Section 32(1)(i) cannot be proportionately disallowed under Section 38.

Note 1: No depreciation shall be charged on the block of asset in the following two situations

Situation 1 : Section 50(1) when Block of assets is not empty but its written down value is nil at end of the previous year,

Situation 2: Section 50(2) when Block of assets is empty at end of previous year.

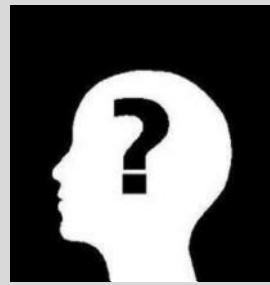
Note 2: Depreciation is chargeable in respect of an asset at 50% of Normal rate of depreciation applicable to the block to which such asset belongs if the following conditions are satisfied:

Condition 1: asset is acquired during a previous year and it is put to use in same previous year and

Condition 2: asset is put to use for less than 180 days in such year.

The rates of depreciation is gives at the end of this lesson as **Annexure**.

Test Your Knowledge



3. If a factory of an assessee is shifted to new site, the expenses of shifting the depreciable asset or its installation would form part of the actual cost.

- True
- False

Incentive for acquisition and installation of new plant or machinery by manufacturing company (Section 32AC)

If a company, –

- (a) is engaged in the business of manufacture and production of an article or thing; and
- (b) invests a sum of more than ₹ 100 crore in new assets (plant or machinery) during the period 1st April, 2013 to 31st March, 2015, then,
 - (i) for assessment year 2014-15, a deduction of 15% of aggregate amount of actual cost of new assets acquired and installed during the financial year 2013-14, if the cost of such assets exceeds Rs.100 crore shall be allowed;
 - (ii) for assessment year 2015-16, a deduction of 15% of the WDV as on 1st April 2015 shall be allowed.

The phrase “new asset” has been defined as new plant or machinery but does not include –

- (i) any plant or machinery which before its installation by the assessee was used either within or outside India by any other person;
- (ii) any plant or machinery installed in any office premises or any residential accommodation, including accommodation in the nature of a guest house;
- (iii) any office appliances including computers or computer software;
- (iv) any vehicle;
- (v) ship or aircraft; or
- (vi) any plant or machinery, the whole of the actual cost of which is allowed as deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head “Profits and gains of business or profession” of any previous year.

Transfer of the plant or machinery for a period of 5 years has also been restricted. However, this restriction shall not apply in a case of amalgamation or demerger but shall continue to apply to the amalgamated company or resulting company, as the case may be.

(D) Tea/Coffee/Rubber Development Account (Section 33AB)

With effect from the assessment year 1991-92, the substituted Section 33AB is applicable to an assessee carrying on the business of growing and manufacturing tea in India. For claiming the deduction u/s 33AB the assessee has to satisfy the following conditions:

(1) Deposit of amount:

Where an assessee, carrying on business of growing and manufacturing tea or coffee or rubber in India has, before the expiry of six months from the end of the previous year or before the due date of furnishing the return of his income, whichever is earlier:

- (a) Deposited with the National Bank any amount or amounts in an account (hereinafter in this section referred to as the special account) maintained by the assessee with the Bank in accordance with and for the purposes specified in a scheme (hereafter in this section referred to as the scheme) approved in this behalf by the Tea Board of India or the Coffee Board of India or the Rubber Board; or
- (b) Amount of Deduction:

Deposited any amount in an account (hereafter in this section referred to as the Deposit Account) opened by the assessee in accordance with, and for the purposes specified in, a scheme framed by the Tea Board or the Coffee Board or the Rubber Board, as the case may be (hereafter in this section referred to as the deposit scheme) with the previous approval of the Central Government, the assessee, shall be allowed a deduction (before the loss, if any, brought forward from earlier years is set off under Section 72), of –

- (a) a sum equal to the amount or the aggregate of the amounts so deposited; or
- (b) Forty per cent of the profits of such business (computed under the head "Profits and gains of business or profession" before making any deduction under Section 33AB), whichever is less.

However, where such assessee is a firm, any association of persons or body of individuals, deduction under this section shall not be allowed in the computation of the income of any partner, or member etc., of the firm/ AOP/BOI.

Also, where any deduction, in respect of any amount deposited in the special account has been allowed in any previous year, no deduction shall be allowed in respect of any other previous year.

(2) Audit:

The deduction is admissible to only those assessees whose accounts have been audited and the assessee furnishes along with his return of income the report of such audit in the prescribed form and duly signed and verified by such accountant. In cases where the accounts of the tax payer are required to be audited under any other law, it would be sufficient if the accounts are audited under that law and the audit report as per that law is furnished with the return along with a further report in the form prescribed for the purposes of this provision.

(3) Withdrawal of Amount:

- (a) There is a restriction on the withdrawal of the amount standing in the credit of such Special account of the assessee, i.e., the withdrawal must be made either: (i) for the purposes specified in the scheme, or, in the following circumstances: (a) closure of business; (b) death of an assessee; (c) partition of a H.U.F.; (d) dissolution of a firm; (e) liquidation of a company.
- (b) Notwithstanding anything contained in (a) above, where any amount standing to the credit of the assessee in the special account or in the Deposit Account is released during any previous year by the National Bank or withdrawn by the assessee from the Deposit Account and such amount is utilised for the purchase of:

- (a) any machinery or plant to be installed in any office premises or residential accommodation, including any accommodation in the nature of a guest-house;
- (b) any office appliances (not being computers);
- (c) any machinery or plant, the whole of the actual cost of which is allowed as a deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and gains of business or profession" of any one previous year;
- (d) any new machinery or plant to be installed in an industrial undertaking for the purposes of business of construction, manufacture or production of any article or thing specified in the list in the Eleventh Schedule, the whole of such amount so utilized shall be deemed to be the profits and gains of business of that previous year and shall accordingly be chargeable to income-tax as the income of that previous year.

(4) Consequences in case of closure of Business:

In the event of withdrawal of any amount in the event of: (a) closure of business or; (b) dissolution of a firm, the whole of such amount shall be deemed to be the profits and gains of business or profession of that previous year and chargeable to income-tax as if the business had not closed, or, the firm not dissolved and taxable in that previous year.

- (5) Conversely, where any amount standing to the credit of the assessee in the special account or in the Tea Deposit Account is utilised by the assessee for the purposes of any expenditure in connection with such business in accordance with the scheme, such expenditure shall not be allowed as a revenue deduction in computing the income chargeable under the head "Profits and gains of business or profession".
- (6) Non-utilisation of any amount released by the National Bank, for being utilised by the assessee for the purposes of a business, in accordance with the scheme, renders the whole or part of the amount not utilised, as the case may be, deemed as profits and gains of business and, accordingly, chargeable to income-tax as income of that previous year. The exceptions to this provision are, when the amount is not utilised in the cases of: (i) death of an assessee; (ii) partition of a Hindu undivided family; (iii) liquidation of a company.

(7) Acquisition of Assets:

In cases where the asset acquired in accordance with the scheme or deposit scheme is sold or otherwise transferred in any previous year by the assessee to any person, at any time before the expiry of eight years from the end of the previous year in which it was acquired, such part of the cost of the asset as is relatable to the deduction already allowed is deemed to be the profits and gains of business or profession of the previous year in which the asset is sold or otherwise transferred and charged to income-tax accordingly.

But, these provisions do not apply where:

- (i) the asset is sold or otherwise transferred by the assessee to Government, local authority, corporation established by or under a Central, State or Provincial Act or a Government company as defined in Section 617 of the Companies Act, 1956; or
- (ii) Where the sale or transfer of the asset is made in connection with the succession of a firm by a company in the business or profession carried on by the firm as a result of which the firm sells or otherwise transfers to the company any asset and the scheme or the deposit scheme continues to apply to the company in the manner applicable to the firm only where,
 - (i) all the properties of the firm relating to business or profession immediately before the succession become the properties of the company;
 - (ii) all the liabilities of the firm relating to the business or profession immediately before the succession become the liabilities of the company; and

- (iii) all the shareholders of the company were partners of the firm immediately before the succession.
- (a) "Coffee Board" means the Coffee Board constituted under Section 4 of the Coffee Act, 1942 (7 of 1942);
- (aa) "National Bank" means the National Bank for Agriculture and Rural Development established under Section 3 of the National Bank for Agriculture and Rural Development Act, 1981 (61 of 1981);
- (ab) "Rubber Board" means the Rubber Board constituted under Sub-section (1) of Section 4 of the Rubber Board Act, 1947 (24 of 1947);
- (b) "Tea Board" means the Tea Board established under Section 4 of the Tea Act, 1953 (29 of 1953).

(E) Site restoration fund [Section 33ABA]

An assessee can claim deduction under Section 33ABA, with effect from the assessment year 1999-2000, if certain conditions are satisfied:

The assessee must satisfy the following conditions:

- 1. Production of petroleum or natural gas:** The taxpayer is engaged in the business of the prospecting for, or extraction or production of, petroleum or natural gas or both in India.
- 2. Agreement:** The Central Government has entered into an agreement with the taxpayer for such business.
- 3. Deposit:**
 - (a) deposit with SBI any amount in an account (hereinafter referred to as special account) maintained by the assessee with that bank in accordance with and for the purpose specified in, a scheme approved by the Government of India in the Ministry of Petroleum and Natural Gas; or
 - (b) deposit any amount in an account (hereinafter referred to as site restoration account) opened by the assessee in accordance with, and for the purposes specified in, a scheme framed by the Ministry of Petroleum and Natural Gas (hereinafter referred to deposit scheme).

The aforesaid amount shall be deposited before the end of the previous year.

- 4. Audit:**

The accounts of the taxpayer should be audited by an accountant as defined in the Explanation below Sub-section (2) of Section 288 and the report of the auditor is filed along with the return of the relevant assessment year.

Provided that, in case where the accounts of the taxpayer are required to be audited under any other law, e.g. under the Companies Act, it would be sufficient if the accounts are audited under that law and the audit report as per that law is furnished with the return along with a further report in the form prescribed for the purposes of the provision.

- 5. Amount of deduction:**

- (a) a sum equal to amounts deposited as mentioned in Point No. 2 above; or
- (b) 20 per cent of the profit of such business computed under the head "Profits and gains of business or profession" before making any deduction under Section 33ABA and before adjusting brought forward business loss under Section 72,

whichever is less.

However:

1. Where any deduction is claimed under this section, no deduction shall be allowed in respect of such amount in any other previous year.

2. Where a deduction is claimed and allowed under this section, to a firm, association of persons or body of individuals, no deduction shall be allowed to any partner of the firm or the member of the association or body in respect of the same deposit.

The amount standing to the credit of such special account or site restoration account may be withdrawn only for the purpose specified in the scheme or deposit scheme. If the amount released by SBI or the amount withdrawn from site restoration account in a year is not utilized in the same previous year for the purpose for which it is released, the amount not so utilized will be treated as taxable profits of that year and taxed accordingly.

Where any amount standing to the credit of the assessee in the special account or in the Site Restoration Account is withdrawn on closure of the account during any previous year by the assessee, the amount so withdrawn from the account as reduced by the amount, if any, payable to the Central Government by way of profit or production share as provided in the agreement referred to in Section 42, shall be deemed to be the profits and gains of business or profession of that previous year and shall accordingly be chargeable to income-tax as the income of that previous year. Where any amount is withdrawn on closure of the account in a previous year in which the business carried on by the assessee is no longer in existence, the above provisions shall apply as if the business is in existence in that previous year.

There is an overriding condition that the deduction under this provision cannot be claimed in relation to amounts utilized for the purpose of any machinery or plant to be installed in any office premises or residential accommodation including guest house; any office appliance, other than computers; any other plant or machinery which either is installed in an undertaking producing low priority items specified in the Eleventh Schedule in the Act or is an item of plant or machinery entitled to 100 per cent write off by way of depreciation or for any other reason in any one year.

The deduction allowed under this provision will be withdrawn if the asset acquired in accordance with the scheme is sold or otherwise transferred within 8 years from the end of the previous year in which it is acquired. For this purpose, the cost of the asset relatable to the deduction allowed will be treated as taxable business profits of the year in which the asset is sold or otherwise transferred.

The deduction allowed earlier will, however, not be withdrawn in cases where the asset is transferred within 8 years period to Government, local authority statutory corporation or Government company.

It will also not be withdrawn where the transfer takes place in connection with succession of a firm by a company. For this purpose it is necessary that:

- (a) the scheme continues to apply to the company in the manner applicable to the firm;
- (b) the successor company takes over all the assets and liabilities of the firm; and
- (c) all the shareholders of the company were partners of the firm before the succession.

(F) Reserves for Shipping Business (Section 33AC)

No deduction under this section shall be allowed under this section for any assessment year commencing on or after 1st day of April, 2005 i.e from assessment year 2005-06.

(G) Expenditure on Scientific Research (Section 35)

The term "scientific research" means any activity for the extension of knowledge in the fields of natural or applied sciences including agriculture, animal husbandry or fisheries. With a view to accelerating scientific research, Section 35 of the Act provides tax incentives.

(1) Revenue expenditure incurred by an assessee

(i) Assessee himself carries on scientific research [Section 35(1)(i)]

Where the assessee himself carries on scientific research and incurs revenue expenditure, deduction is allowed for such expenditure only if the research relates to his business.

Pre-commencement period expenses:

Further, revenue expenditure incurred by an assessee on payment of salary to research personnel and on material inputs during the period of 3 years immediately preceding the commencement of the business is regarded as having been laid out or expended in the previous year in which the business is commenced only salary is allowed if it is incurred for 3 years immediately preceding the previous year. Such expenditure incurred in the period before commencement of business is, therefore, allowed as deduction in computing assessee's income of the year in which the business is commenced. The deduction is available only in respect of expenditure incurred after March 31, 1973 on scientific research related to the assessee's business. In order to prevent misuse of the concession, deduction is limited to an amount certified by the prescribed authority. Prescribed authority as per rule 6 is Director General (Income-tax Exemptions) in concurrence with the Secretary, Department of Scientific and Industrial Research, Government of India. The 'salary' allowable for this purpose includes wages, annuity, pension or gratuity, fees or commission, profits in lieu of or in addition to any salary or wages, advance of salary and annual accretion to the balance at the credit of the employee participating in a recognised provident fund to the extent to which it is chargeable to tax under rule 6 of Part A of the Fourth Schedule. It may be mentioned that expenditure incurred on the provision of "perquisites" before commencement of business is not allowed as deduction. In other words, expenditure incurred by the assessee on providing different perquisites (such as concessional residential accommodation, or any benefit or amenity provided free of cost or at a concessional rate etc.) to research personnel before commencement of business is not allowable as deduction.

(ii) Contribution made to outsiders [Section 35(1)(ii) & (iii)]

Where the assessee does not himself carry on scientific research but makes contributions to other institutions for this purposes deduction is allowed, if:

- (a) the payment is made to an approved research association which has, as its object, undertaking of research related or unrelated to the business of assessee, a deduction of 175% of expenditure incurred is allowed.[Section 35(1)(ii)];
- (b) the payment is made to an approved university, college or institution to be used for scientific research related or unrelated to the business of assessee [Section 35(1)(ii)], deduction shall be allowed to the extent of 175% of the actual expenditure.
- (c) the payment is made to an approved company to be used by it for scientific research, deduction shall be allowed to the extent of 125% of the sum paid provided such company;
 - (i) is registered in India,
 - (ii) has as its main object the scientific research and development,
 - (iii) is, for the purposes of this clause, for the time being approved by the prescribed authority in the prescribed manner, and
 - (iv) fulfills such other conditions as may be prescribed.

a deduction of 125% of the sum paid shall be allowed as deduction. [Section 35(1)(iia)]

- (d) the payment is made to a research association which has its object the undertaking of research in social science or statistical research or to a university, college or institution for the use of research in social sciences or statistical research, related or unrelated to the business of the assessee provided such university, college or institution is, for the time being, approved by the Central Government by notification in the Official Gazette [Section 35(1)(iii)], deduction shall be allowed to the extent of 125% of the sum paid.

The approval to research association, university, college or institution mentioned above is required to be obtained from the Central Government as provided by Finance Act, 1999 w.e.f. 1.4.2000.

The deduction available for such payments mentioned in clauses (a), (b) and (c) above to the extent of one and one-fourth times of any sum paid; with effect from Assessment Year 2000-01.

(2) Capital expenditure on scientific research

(i) Incurred by the assessee himself: Expenditure of a capital nature on scientific research related to the business carried on by the assessee is also allowable to the following extent:

- (a) Where the capital expenditure is incurred after March 31, 1967, the whole of the capital expenditure incurred in any previous year is deductible for that previous year. However, expenditure incurred on the acquisition of any land, whether acquired as such or part of any property, after 29.2.1984, is not deductible.
- (b) Capital expenditure incurred before the commencement of the business is deemed to have been incurred in the previous year in which the business is commenced, to the extent of the aggregate of the expenditure so incurred within the three years immediately preceding the commencement of the business.

Where an asset representing expenditure of a capital nature incurred before 1.4.1967, ceases to be used in a previous year for scientific research related to the business and the value of the asset at the time of the cessation, together with the aggregate of deductions already allowed falls short of the said expenditure then - (i) the deficiency is allowable as a deduction for the relevant previous year. Thereafter, no further deduction is allowable for any subsequent previous year.

Also in the case of sale of such assets, without use thereof for other purposes, in the year of cessation, the sale price shall be taken to be the value of the asset at the time of cessation and if the asset is sold without having been used for other purposes, in a previous year subsequent to the year of cessation and the sale price falls short of the value of the asset taken into account at the time of cessation, the deficiency shall be allowed as a deduction for the previous year in which the sale took place.

Deduction by way of depreciation is not admissible in respect of an asset used in scientific research either in the year in which the capital expenditure is incurred or in a subsequent year. However, in the event of use of such assets for business, after cessation of use thereof for scientific research related to that business, the same asset shall become entitled to depreciation.

(ii) Carry forward and set off of deficiency in subsequent years:

If on account of inadequacy or absence of profits of the business, deduction on account of capital expenditure referred to in Section 35(1)(iv) of the Act cannot be allowed, fully or partly, the deficiency so arising is to be carried forward for 8 years and set off in any subsequent assessment year. However, carry forward of deficiency is subject to the condition that business loss already brought forward, if any, will have precedence over such deficiency in the matter of set off. To put it little differently, the aforesaid deficiency will be given the same treatment as is given to unabsorbed depreciation vis-a-vis brought forward business losses.

(iii) Consequences in case of amalgamation:

In pursuance of an agreement of amalgamation, if the amalgamating company transfers to the amalgamated company, which is an Indian company, any asset representing capital expenditure on scientific research, provisions of Section 35 would apply to the amalgamated company as they would have applied to the amalgamating company if the latter had not transferred the asset.

To avail the benefit of this section, the following procedures have also to be complied with:

- The research association, university, college or other institution makes an application in the prescribed form and manner to the Central Government for grant of approval or continuance of the scientific research.
- Before grant of the approval so sought, the Central Government may call for such documents including audited annual accounts or information from the research association, university, college, or other institution as it thinks necessary to satisfy itself about the genuineness of the activities of the research

association, university, college or other institution. The prescribed authority is also empowered to make such inquiries as it may deem necessary, in this behalf, and

- The notification issued by the Central Government shall have effect for such assessment year or years, upto a maximum of three assessment years, including the assessment year or years commencing before the date on which the notification is issued, as may be specified in the notification.

Any question as to what extent an activity constitutes scientific research or any asset was being used for scientific research, if arises it will be referred to the prescribed authority and its decision shall be final.

However, any such question relating to any activity of research association or university, college or other institution for which weighted deduction of one and one-fourth times the payment amount is given and for which approval from Central Government is required to be obtained, the question is also required to be referred to Central Government only and not to prescribed authority.

(3) Contribution to National Laboratory [section 35(2AA)]

Where any sum is paid to a National Laboratory, approved for this purpose by the Indian Council of Agricultural Research or the Indian Council of Medical Research or the Council of Scientific and Industrial Research etc., or to any University, or to Indian Institute of Technology, a weighted deduction of 200% of the sum paid shall be allowed as deduction under Section 35(2AA) of the Act.

(4) Expenditure on in-house research and development expenses [Section 35(2AB)]

Where a company engaged in the business of bio-technology or in any business of manufacture or production of any article or thing, not being an article or thing specified in the list of the Eleventh Schedule incurs any expenditure on scientific research (not being expenditure in the nature of cost of any land or building) on in-house research and development facility as approved by the prescribed authority, then, there shall be allowed a deduction of a sum equal to 200% of the expenditure so incurred upto 31.03.2017.

(H) Expenditure on Acquisition of Patent Rights or Copyrights (Section 35A)

Capital expenditure incurred by all assessees at any time after 28.2.1966 but before 1st April, 1998 for the purpose of acquisition of patent rights or copyrights for the purposes of his business, would be allowed to be amortised over a period of 14 years in equal instalments beginning with the previous year in which such expenditure is incurred or where such expenditure is incurred before the commencement of the business, the fourteen previous years would be calculated from the previous year in which the business commenced. With effect from 1.4.98 depreciation on intangible assets has been introduced. It is charged @25%. In view of this change expenditure under this section need not be amortised if incurred after the given date. However, where the rights became effective in a year prior to the one in which the expenditure is incurred, the deduction would be allowable to the assessee in respect of that period as remains unexpired. In other words, if at the time of acquisition (incurring the expenses) of the patent, say, the patent has already been utilized for 10 years by the assessee, the cost of the patent would be allowed as a deduction in four equal instalments in the remaining four years. In cases where the assessee acquires the patent or copyright at a time when only one year of its life remains, the entire cost of the patent to the assessee would be allowed in the year of acquisition itself. The other provisions relating to the allowance of deduction in respect of capital expenditure incurred for acquiring patents or copyrights are as under:

- (i) Where a part of the right is sold and the proceeds of the sale are not less than the cost of acquisition thereof remaining unallowed, no deduction shall be allowed in respect of the previous year in which a part is so sold and in respect of any subsequent previous year.
- (ii) Where the rights either come to an end or are sold in their entirety and the proceeds of sale are less than the cost of acquisition thereof remaining unallowed, a deduction equal to such cost remaining unallowed or as the case may be such cost remaining unallowed, as reduced by the proceeds of the sale, shall be allowed in the year in which rights come to an end or are sold.

- (iii) Where the whole or any part of the rights is sold at a profit, the profits shall be chargeable as balancing charge. In case of the sale of the rights in the year in which the business is no longer in existence, the profits shall be chargeable as if the business is in existence in that previous year.
- (iv) Where a part of the rights is sold and (iii) above does not apply the amount of deduction for that year and the subsequent year shall be calculated as follows:
 - (a) subtract the proceeds of sale from the cost of acquisition of the rights remaining unallowed; and
 - (b) divide the remainder by the number of previous year which have not expired at the beginning of the year in which the rights are sold.
- (v) In case of amalgamation of companies, the amalgamated company (being an Indian company) is entitled to continuation of benefits in the same way as amalgamating company would have enjoyed, if it has not so sold or otherwise transferred the rights.

Similarly, in case of demerger of companies, the resulting company (being an Indian company) is entitled to continuation of benefits in the same way as demerged company would have enjoyed, if it had not so sold or otherwise transferred the rights.

Note : Now, no deduction under this section is allowed.

(I) Deduction in respect of expenditure on know-how (Section 35AB)

Any lump sum consideration paid by the assessee in any previous year relevant to the assessment year commencing on or before 1st April, 1998 for acquiring any know-how for use for the purpose of his business will be allowed as deduction by spreading it equally over six years, namely, the year in which the lump sum consideration is paid and the five immediately succeeding years. With effect from 1.4.98 depreciation on intangible assets has been introduced and charged @25%. In view of this change expenditure under this section is not to be amortised if incurred after the given date. Where the know-how is developed in a laboratory, University or institution etc., the consideration shall be spread equally over 3 years. In case of transfer of business under the scheme of amalgamation or demerger where amalgamating or the demerged company is entitled to a deduction under this section, then the amalgamated company or the resulting company, as the case may be shall be entitled to claim deduction under this sub- section for the residual period as if the business or the undertaking had continued. For the purpose of this section "know-how" means any industrial information or technique likely to assist in the manufacture or processing of goods or in the working of a mine, oil well or other sources of mineral deposits (including searching for, discovery or testing of deposits or winning of access thereto).

Now a days no deduction is available under section 35AB.

(J) Expenditure on telecom licence (Section 35ABB)

Where any capital expenditure is incurred by the assessee for acquiring any right to operate telecommunications services and for which payment has actually been made to obtain a licence, a deduction will be allowed in equal instalments over the period for which the licence remains in force, subject to the following:

- (a) If the fee is paid for acquiring any right to operate telecommunications services before the commencement of such business, the deduction shall be allowed for the previous years beginning with the previous year in which such business is commenced.
- (b) If the fee is paid for acquiring such rights after the commencement of such business the deduction shall be allowed for the previous years beginning with the previous year in which the license fee is actually paid (irrespective of the previous year in which the liability for the expenditure is incurred).

Profit/loss on Sale -

- Where the licence is transferred and proceeds of transfer (sale proceeds) are less than the amount of

expenditure incurred remaining unallowed:

- (i) Where whole of the licence is transferred in a previous year. Deduction as given below shall be allowed in the previous year in which the licence is transferred.

Expenditure remaining unallowed less sale proceeds.

- (ii) Where part of the licence is transferred in a previous year. Deduction as given below shall be allowed in the balance number of relevant previous years.

(expenditure remaining unallowed less sale proceeds) divided by balance number of relevant previous years, i.e., the previous years not expired at the beginning of the year of transfer.

- Where the licence is transferred and the proceeds of transfer (sale proceeds) exceed the amount of expenditure incurred remaining unallowed.

Sale proceeds less expenditure remaining unallowed subject to deductions already allowed shall be chargeable to income tax as profits and gains of the business in the previous year in which licence is transferred. Consequently, no further deduction in the previous year in which licence is transferred or in any subsequent previous years is allowed.

Where licence is transferred in a previous year in which the business is no longer in existence, the provisions of this sub-section shall apply as if the business is in existence in that previous year.

- Where under a scheme of amalgamation a telecom licence is transferred by the amalgamating company to the amalgamated company (being an Indian company), then deduction will not be available under this section to the amalgamating company, instead the provisions of this Section (35ABB) will continue to apply to the amalgamated company as they would have applied to the amalgamating company if the latter had not transferred the licence.
- Similarly in a scheme of demerger a telecom licence is transferred by the demerged company to the resulting company, then deduction will not be available to the demerged company and will instead apply to the resulting company as they would have applied to the demerged company if the latter had not transferred the licence.

Further where a deduction for any previous year is claimed and allowed under Section 35ABB, then no deduction under Section 32(1) shall be allowed for the same or any subsequent previous year.

(K) Expenditure on Eligible projects or schemes (Section 35AC)

Section 35AC has been inserted by Finance (No. 2) Act, 1991 from the assessment year 1992-93 onwards. Under this section an assessee is allowed a deduction in computing profits of business or profession in respect of any expenditure by way of payment of any sum to a public sector company or a local authority or to an association or institution approved by the National Committee for carrying out any eligible project or scheme.

For this purpose 'eligible project or scheme' means such project or scheme for promoting the social and economic welfare of, or the upliftment of the public as the Central Government may on the recommendations of the National Committee notify in the Official Gazette.

National Committee for this purpose will be the Committee constituted by the Central Government, from amongst the persons of eminence in public life.

In addition to the aforesaid mode of payment a company can claim deduction by expending directly on the eligible project or scheme.

In order to claim deduction the assessee has to furnish along with his return of income a certificate –

- (a) from the public sector company, or local authority or as the case may be association or institution where the payment is made through these bodies.

- (b) in any other case (like payment made directly by a company on the eligible projects in scheme) from a Chartered Accountant.

in such manner, form and containing such particulars as may be prescribed.

Further, a deduction under this section if, is claimed and allowed for any assessment year, disentitles the assessee from claiming deduction in respect of such expenditure under any other provision of this Act for the same or any other assessment year.]

(L) Expenditure of capital nature incurred in respect of specified business (Section 35AD)

(1) An assessee shall be allowed a deduction of capital nature expenditure incurred for any specified business carried on by him during the previous year in which such expenditure is incurred by him.

(1A) Where the specified business is of the nature referred to in sub-clause (i) or sub-clause (ii) or sub-clause (v) or sub-clause (vii) or sub-clause (viii) of clause (c) of sub-section (8) and has commenced its operations on or after the 1st day of April, 2012, the deduction under sub-section (1) shall be allowed of an amount equal to one and one-half times of the expenditure referred to therein.

(2) This section applies to the specified business which fulfils all the following conditions:

- (i) it is not set up by splitting up, or the reconstruction, of a business already in existence;
- (ii) it is not set up by the transfer to the specified business of machinery or plant previously used for any purpose;
- (iii) where the business is of the nature referred to in sub-clause (iii) of clause (c) of subsection (8), such business,
 - (a) is owned by a company formed and registered in India under the Companies Act, 1956 or by a consortium of such companies or by an authority or a board or a corporation established or constituted under any Central or State Act;
 - (b) has been approved by the Petroleum and Natural Gas Regulatory Board established under sub-section (1) of section 3 of the Petroleum and Natural Gas Regulatory Board Act, 2006 and notified by the Central Government in the Official Gazette in this behalf;
 - (c) has made not less than such proportion of its total pipeline capacity as specified by regulations made by the Petroleum and Natural Gas Regulatory Board established under sub-section (1) of section 3 of the Petroleum and Natural Gas Regulatory Board Act, 2006 available for use on common carrier basis by any person other than the assessee or an associated person; and
 - (d) fulfils any other condition as may be prescribed.

(3) The assessee shall not be allowed any deduction under Chapter VI-A under the heading "C.—Deductions in respect of certain incomes" in relation to such specified business for the same or any other assessment year where a deduction under this section is claimed and allowed.

(4) No deduction in respect of the expenditure referred to in sub-section (1) shall be allowed to the assessee under any other section in any previous year or under this section in any other previous year.

(5) The provisions of this section shall apply to the specified business referred to in sub-section (2) if it commences its operations,

- (a) on or after the 1st day of April, 2007, where the specified business is in the nature of laying and operating a cross-country natural gas pipeline network for distribution, including storage facilities being an integral part of such network;
- (aa) on or after the 1st day of April, 2010, where the specified business is in the nature of building and operating a new hotel of two-star or above category as classified by the Central Government; and

- (ab) on or after the 1st day of April, 2010, where the specified business is in the nature of building and operating a new hospital with at least one hundred beds for patients;
 - (ac) on or after the 1st day of April, 2010, where the specified business is in the nature of developing and building a housing project under a scheme for slum redevelopment or rehabilitation framed by the Central Government or a State Government, as the case may be, and which is notified by the Board in the behalf in accordance with guidelines as may be prescribed.
 - (ad) on or after the 1st day of April, 2011, where the specified business is in the nature of developing and building a housing project under a scheme for affordable housing framed by the Central Government or a State Government, as the case may be, and notified by the Board in this behalf in accordance with the guidelines as may be prescribed;
 - (ae) on or after the 1st day of April, 2011, in a new plant or in a newly installed capacity in an existing plant for production of fertilizer;
 - (af) on or after the 1st day of April, 2012, where the specified business is in the nature of setting up and operating an inland container depot or a container freight station notified or approved under the Customs Act, 1962 (52 of 1962);
 - (ag) on or after the 1st day of April, 2012, where the specified business is in the nature of bee-keeping and production of honey and beeswax;
 - (ah) on or after the 1st day of April, 2012, where the specified business is in the nature of setting up and operating a warehousing facility for storage of sugar; and
 - (b) on or after the 1st day of April, 2009, in all other cases not falling under clause (a), clause (aa), clause (ab), clause (ac), clause (ad) and clause (ae)
- (6) The assessee carrying on the business of the nature referred to in clause (a) of sub-section (5) shall be allowed, in addition to deduction under sub-section (1), a further deduction in the previous year relevant to the assessment year beginning on the 1st day of April, 2010, of an amount in respect of expenditure of capital nature incurred during any earlier previous year, if –
- (a) the business referred to in clause (a) of sub-section (5) has commenced its operation at any time during the period beginning on or after the 1st day of April, 2007 and ending on the 31st day of March, 2009; and
 - (b) no deduction for such amount has been allowed or is allowable to the assessee in any earlier previous year.
- (6A) Where the assessee builds a hotel of two-star or above category as classified by the Central Government and subsequently, while continuing to own the hotel, transfers the operation thereof to another person, the assessee shall be deemed to be carrying on the specified business referred to in sub-clause (iv) of clause (c) of sub-section (8).
- (7) The provisions contained in sub-section (6) of section 80A and the provisions of sub-sections (7) and (10) of section 80-IA shall, so far as may be, apply to this section in respect of goods or services or assets held for the purposes of the specified business.
- (a) *an "associated person", in relation to the assessee, means a person,*
 - (i) *who participates, directly or indirectly, or through one or more intermediaries in the management or control or capital of the assessee;*
 - (ii) *who holds, directly or indirectly, shares carrying not less than twenty-six per cent. of the voting power in the capital of the assessee;*

- (iii) who appoints more than half of the Board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of the assessee; or
- (iv) who guarantees not less than ten per cent. of the total borrowings of the assessee;
- (b) "cold chain facility" means a chain of facilities for storage or transportation of agricultural and forest produce, meat and meat products, poultry, marine and dairy products, products of horticulture, floriculture and apiculture and processed food items under scientifically controlled conditions including refrigeration and other facilities necessary for the preservation of such produce;
- (c) "specified business" means the any one or more of the following business, namely
 - (i) setting up and operating a cold chain facility;
 - (ii) setting up and operating a warehousing facility for storage of agricultural produce;
 - (iii) laying and operating a cross-country natural gas or crude or petroleum oil pipeline
 - (iv) building and operating, anywhere in India, a hotel of two-star or above category as classified by the Central Government.
 - (v) Building and operating anywhere in India, a hospital with at least one hundred beds for patients;
 - (vi) developing and building a housing project under a scheme for slum redevelopment or rehabilitation framed by the Central Government or a State Government, as the case may be, and which is notified by the Board in the behalf in accordance with guidelines as may be prescribed.
 - (vii) developing and building a housing project under a scheme for affordable housing framed by the Central Government or a State Government, as the case may be, and notified by the Board in this behalf in accordance with the guidelines as may be prescribed;
 - (viii) production of fertilizer in India;
 - (ix) setting up and operating an inland container depot or a container freight station notified or approved under the Customs Act, 1962 (52 of 1962);
 - (x) bee-keeping and production of honey and beeswax; and
 - (xi) setting up and operating a warehousing facility for storage of sugar
- (d) any machinery or plant which was used outside India by any person other than the assessee shall not be regarded as machinery or plant previously used for any purpose, if
 - (i) such machinery or plant was not, at any time prior to the date of the installation by the assessee, used in India;
 - (ii) such machinery or plant is imported into India from any country outside India; and
 - (iii) no deduction on account of depreciation in respect of such machinery or plant has been allowed or is allowable under the provisions of this Act in computing the total income of any person for any period prior to the date of the installation of the machinery or plant by the assessee;
- (e) where in the case of a specified business, any machinery or plant or any part thereof previously used for any purpose is transferred to the specified business and the total value of the machinery or plant or part so transferred does not exceed twenty per cent. of the total value of the machinery or plant used in such business, then, for the purposes of clause (ii) of sub-section (2), the condition specified therein shall be deemed to have been complied with;
- (f) any expenditure of capital nature shall not include any expenditure incurred on the acquisition of any land or goodwill or financial instrument.

(M) Expenditure by way of Payment to Associations and Institutions for carrying out Rural Development Programmes (Section 35CCA)

Any sum paid to a rural development fund set up and notified by the Central Government and to the National Urban Poverty Eradication Fund similarly set up and notified qualifies for deduction on fulfillment of certain conditions.

(N) Expenditure by way of Payment to Associations and Institutions for carrying out Programmes of Conservation of Natural Resources (Section 35CCB)

Sums paid on or before 31.3.2002 by an assessee carrying on business or profession to an approved association or institution which has as its object the undertaking of any programme of conservation of Natural resources (or of afforestation w.e.f. the assessment year 1991-92) to be used for such programme, are allowed a deduction of the amount of such expenditure incurred during the previous year. The deduction under this provision is not allowed unless the association or institution is for the time being approved by the prescribed authority. As per Rule 6AAC, the prescribed authority for this purpose is Secretary, Department of Environment, Government of India. Further, the prescribed authority shall not grant such approval for more than three years at a time.

Also, where an assessee carrying on business or profession incurs any expenditure by way of payment of any sum to any fund for afforestation as notified by Central Government, such sum is allowed as a deduction (in the previous year) in computing taxable profits.

(O) Expenditure on agricultural extension project (Section 35CCC)

Where an assessee incurs any expenditure on agricultural extension project notified by the Board then, there shall be allowed a deduction of a sum equal to 150% of such expenditure.

(P) Expenditure on skill development project (Section 35CCD)

Where a company incurs any expenditure (not being expenditure in the nature of cost of any land or building) on any skill development project notified by the Board then, there shall be allowed a deduction of a sum equal to 150% of such expenditure.

(Q) Amortisation of Preliminary Expenses (Section 35D)

Under Section 35D, Indian companies and other non-corporate taxpayers resident in India would be entitled to amortisation of certain preliminary expenses incurred by them at any time after 31.3.1970.

The expenditure which qualifies for amortisation should have been incurred by the assessee:

- (i) before the commencement of his business,
- (ii) if however, the expenditure is incurred after the commencement of business, it is essential that the expenditure should be in connection with the extension or expansion of the undertaking of the assessee or in connection with the setting up of a new unit by the assessee.

Amount of Deduction:

The amount qualifying for amortisation would be allowable as a deduction in five equal instalments beginning with the previous year in which the business of the assessee actually commences or the previous year in which the extension of the present undertaking is completed or the new unit commences production or operation, as the case may be.

Qualifying amount of expenses:

The following items of expenses qualify for amortisation under this section as preliminary expenses:

- (i) expenditure incurred by the assessee in connection with the preparation of feasibility report or project report;

- (ii) expenses for conducting market survey or any other survey necessary for the purpose of the business of the assessee;
- (iii) expenditure for getting engineering services related to the business of the assessee;
- (iv) expenses by way of legal charges for drafting any agreement between the assessee and any other person for any purpose relating to the setting up or conduct of the business of the assessee;
- (v) in the case of a company
 - (a) expenses by way of legal charges for drafting the Memorandum and Articles of Association of the Company;
 - (b) expenses for printing the Memorandum and Articles of Association;
 - (c) expenses by way of fees for registration of the company under Companies Act, and
 - (d) expenditure incurred in connection with issue for public subscription of shares or debentures of the company, being underwriting commission, brokerage and the charges of drafting, typing, printing and advertisement of the prospectus; and
- (vi) such other items of expenses not covered by the list specified above which the Central Board of Direct Taxes may prescribe for the purpose of amortisation under this section.

Note: Work mentioned in (i) to (iii) above must be carried out by assessee himself or by a concern approved by CBDT.

Amount qualifying for deduction:

The maximum amount allowable as preliminary expenses qualifying for amortisation should be restricted to an amount calculated at 5% of (a) the cost of the project, or (b) where the assessee is an Indian Company, at the option of the company, of the capital employed in the business of the company or cost of project.

Cost of the Project

For the purpose of amortisation, the expression "Cost of the Project" in relation to the expenses incurred before the commencement of the business means the actual cost of the fixed assets being land, buildings, lease holds, plant, machinery, furniture, fittings and railway sidings, including expenditure on the development of land and buildings, which are shown in the books of accounts of the assessee as on the last day of the accounting year in which the business of the assessee actually commences. Where the expenses are incurred after the commencement of business either in connection with the extension of the present undertaking or in connection with the setting up of a new unit, the cost of the project should be taken to mean the actual cost of the fixed assets, being land, buildings, lease holds, plant, machinery, furniture, fittings and railway sidings, including expenditure on the development of the land and building which are shown in the books of the assessee as on the last day of the previous year in which extension of the undertaking is completed or the new unit commences production or operations, as the case may be, to the extent to which such fixed assets have been acquired or developed in connection with the extension of the undertaking or the setting up of the new unit of the assessee.

Capital Employed

In the case of company, the capital employed in the business means where preliminary expenses have been incurred before the commencement of the business, the aggregate of the issued share capital, debentures and long-term borrowings as on the last day of the accounting year in which the business of the company has actually commenced. In cases where the expenditure has been incurred after the commencement of the business, the capital employed in the business of the company should be taken to be the aggregate of the issued share capital, debentures and long-term borrowings as on the last day of the accounting year in which the extension of the undertaking is completed or, as the case may be, the new unit commences production or operation, to the

extent to which the capital, debentures and long-term borrowings have been issued or obtained in connection with the extension of the undertaking or setting up of the new unit of the company.

Meaning of the long-term borrowings

The expression 'long-term borrowings' to be included as part of the capital employed in the business of the company should be taken to mean:

- (i) any moneys borrowed by the company from the Government or the Industrial Finance Corporation of India or Industrial Credit and Investment Corporation of India or any other financial institution which is eligible for deduction under Section 36(1)(vii) of the Act or any banking institution; or
- (ii) any moneys borrowed or debt incurred by the company in a foreign country in respect of the purchases outside India of capital plant and machinery where the terms of the borrowing provide for repayment of the money borrowed or debt incurred over a period of not less than seven years.

In case of person other than a company or a co-operative society

The allowance towards amortisation of preliminary expenses is subject to the condition that the accounts of the assessee for the year or years in which the preliminary expenses are incurred have been audited by a Chartered Accountant or other accountant specified in Section 288(2) of the Act and, in addition, the assessee furnishes along with his return of income for the first year in which the deduction is claimed the report of audit in the prescribed form, duly signed and verified by the auditor and setting out such other particulars as have been prescribed by the Board for this purpose.

In case of Amalgamation/Demerger

In cases of amalgamation as defined in Section 2(1B) of the Act, the amalgamating company would not be entitled to the allowance towards amortisation of preliminary expenses in the year in which the amalgamation takes place. But the amalgamated company would be entitled to the allowance for the remaining period over which the allowance under this section is available. The total period over which the amortisation is allowable should not exceed ten years or five years as the case may be in the case of both the amalgamating company and the amalgamated company. The allowance under this section would not be denied, in cases of amalgamation, to the amalgamated company merely because the expenditure has not actually been incurred by the amalgamated company. Similarly, in case of demerger where an undertaking of an Indian company which is entitled to the deduction under this section is transferred before the expiry of the said period of 10 years or 5 years (as the case may be), to another company in a scheme of demerger no deduction shall be admissible to the demerged company in the year in which the demerger takes place. The resulting company would be entitled to claim deduction for the balance period under this section. In other words, the deduction for the balance period will be available to resulting company as it would have been available to demerged company, if the demerger had not taken place. In cases where preliminary expenses qualify for amortisation under Section 35D and the allowance claimed by the assessee in this regard is allowed in any assessment year, these expenses would not qualify for any allowance or deduction in respect of any other assessment year or even in the same year under any other provision of the Income-tax Act, 1961.

(R) Amortisation of Expenditure in the case of Amalgamation/Demerger (Section 35DD)

The section provides that where an assessee, being an Indian company, incurs expenditure on or after April 1, 1999 wholly and exclusively for the purpose of amalgamation or demerger, the assessee shall be allowed a deduction equal to one fifth of such expenditure for five successive previous years beginning with the previous year in which amalgamation or demerger takes place. No deduction shall be allowed in respect of the above expenditure under any other provisions of the Act.

(S) Amortisation of Expenditure in the case of Voluntary Retirement Scheme (Section 35DDA)

The object of this section is to provide amortisation of one-fifth every year from the year in which the expenditure is incurred, of expenditure by way of payment of any sum to an employee in connection with his voluntary retirement. It also provides that no deduction would be allowed in respect of such expenditure under any other provision of the Act.

This provision supersedes the view expressed by the CBDT in its circular dated January 23, 2001, that the expenditure has to be treated as capital expenditure with the result that no allowance would be permissible in regard to this expenditure.

(T) Deduction in respect of Expenditure on Prospecting etc. for certain Minerals (Section 35E)

Section 35E of the Income-tax Act provides allowance to amortise the capital expenditure incurred by an assessee towards prospecting for certain minerals. The benefit of amortisation under this section is available to Indian companies and other non-corporate entities resident in India.

The expenditure qualifying for amortisation would cover expenses incurred by the assessee after 31-3-1970 in relation to the operations towards prospecting for, or extraction or production of any of the 27 minerals or 16 groups of associated minerals specified in the Seventh Schedule to the Income-tax Act. The expenditure incurred by the assessee would qualify for amortisation only if the expenditure in question is incurred by the assessee during the year of commercial production and/or in one or more of the four years immediately preceding that year; in any case the expenditure must have been incurred after 31-3-1970 wholly and exclusively on any of the operations relating to the prospecting for any mineral or group of associated minerals or on the development of a mine or other natural deposit of any such mineral or group of associated minerals. However, any portion of the expenditure which is met directly or indirectly by any other person or authority and sale, salvage, compensation or insurance moneys realised by the assessee in respect of any property or right brought into existence as a result of the expenditure should be excluded from the amount of expenses qualifying for amortisation under this section.

The assessee would not be entitled for amortisation under this section in respect of the following three items of expenses namely,-

- (i) Expenditure incurred on the acquisition of the site of the source of any mineral or group of associated minerals or of any right in or over such site.
- (ii) Expenditure on the acquisition of the deposits of such minerals or group of associated minerals or of any right in or over such deposits; or
- (iii) Expenditure of a capital nature in respect of any building, machinery, plant or furniture for which depreciation allowance is available under Section 32 of the Income-tax Act.

(U) Other Deductions

In addition to the various items of expenses and allowances provided by

Sections 30 to 35E, Section 36 grants deduction in respect of the following items:

(i) Insurance Premium

- (a) The assessee is entitled to the deduction of the amount of any premium paid in respect of insurance against risk of damage or destruction of stocks or stores used for the purposes of the business or profession.
- (b) The amount of premium paid by federal milk co-operative society to effect or to keep in force an insurance on the life of the cattle owned by a member of a co-operative society, being a primary society engaged in supplying milk raised by its members to such federal milk co-operative society.

- (c) The amount of any premium paid by cheque by the assessee as an employer to effect or to keep in force an insurance on the health of his employees under a scheme framed in this behalf by –
- the General Insurance Corporation of India formed under Section 9 of the General Insurance Business (Nationalisation) Act, 1972 and approved by the Central Government; or
 - any other insurer and approved by the Insurance Regulatory and Development Authority established under Sub-section (1) of Section 3 of the Insurance Regulatory and Development Act, 1999.

(ii) Bonus

Any amount paid by an employer to his employees as bonus or commission for services rendered would be deductible. This deduction is allowable only in cases where the amount of bonus or commission would not have otherwise been payable to the employees as profits or dividend if it had not been paid as bonus or commission.

Where the bonus is paid during the previous year in respect of an earlier year in terms of an award made during the previous year by the Industrial Tribunal, the deduction will be allowed during the previous year in which the payment is made [*Kalyana Mal Mills Ltd. v. C.I.T.* (1965) 57 ITR p. 261].

Note that with effect from assessment year 1989-90 ceiling on bonus to be allowed as deduction is proposed to be deleted. At the same time the bonus payment shall be covered by the provisions of Section 43B so that they are allowed as deduction only on actual payment basis.

(iii) Interest on Borrowings

The amount of interest paid by a going concern in respect of capital borrowed for the purposes of business or profession would be allowable as a deduction.

Provided that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset for extension of existing business or profession (whether capitalized in the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction.

For the purposes of this allowance, recurring subscription paid periodically by shareholders or subscribers in mutual benefit societies which fulfil such conditions as may be prescribed under the Income-tax Rules would be deemed to be capital borrowed and consequently interest thereon would be allowable as a deduction. The deduction allowable to the assessee in respect of interest on borrowings is not in any way related to the application of the borrowed money for capital or revenue purposes. The only conditions are that the borrowing must be genuine and the money borrowed must be utilized by the assessee wholly and exclusively for the purposes of the business. However, interest on capital contributed or loan given by partners of a firm would not be allowable to the firm as deduction since the capital contributed or loan given by the partners does not represent money borrowed by the firm. Similarly, interest on share capital cannot be claimed by the shareholders or allowed to a company as a deduction since share capital does not represent money borrowed by the company. However, interest on debentures would be allowable as a deduction although the money borrowed by way of debentures might have been utilized for investment in capital assets like buildings, machinery, plant or furniture or other assets.

However, if debenture loan is illusory and colourable, interest paid thereon is not allowable as a deduction.

Interest on capital borrowed for business, which is yet to be set up is not deductible. But interest on capital borrowed for expansion of business is allowable as a deduction.

Where the assessee firm, carrying on the business of suppliers to Government Department, had to borrow money for the purchase of Government Loan Bonds to obtain preference in securing orders for

supply and claimed deduction of interest on such borrowed money it was held that the interest so paid was an admissible deduction under Section 36(1)(iii).

Interest on money borrowed by an assessee for the purpose of payment of income-tax would not be allowable under this section since income-tax liability is a personal liability of the assessee and cannot therefore, be treated as interest on money borrowed for the purposes of the business. Interest paid by the assessee for delayed payment of advance tax is not also deductible under this section because it does not represent interest on money borrowed.

(iii) Discount on zero coupon bond

Any discount given by the assessee as an employer by way of pro rata amount of discount on a zero coupon bond having regard to the period of life of such bond calculated in the manner prescribed would be deductible as business expenditure.

(iv) Contributions to Recognised Provident Fund, Approved Superannuation Fund

Any sum paid by the assessee as an employer by way of contribution towards recognised provident fund or an approved superannuation fund would be deductible in computing the business income of the employer subject to section 43B. However, the contribution must be fixed on some definite basis by reference to the income chargeable under the head 'Salaries'. This deduction is subject to the limits and conditions specified for this purpose under Income-tax Rules. According to Rule 88, the amount to be allowed as a deduction on account of an initial contribution which an employer may make in respect of the past services of an employee admitted to the benefits of a fund shall not exceed 25% of the employee's salary for each year of his past services with the employer as reduced by the employer's contribution, if any, to any provident fund (whether recognised or not) in respect of that employee for each year.

Where the company paid fixed salary plus commission at a fixed percentage of turnover achieved by the employee and contributed to the recognised provident fund on the salary plus commission, it was held to be allowable. [*Gestetner Duplicators (P.) Ltd. v. C.I.T. (1979) 117 ITR p. 1 (S.C.)*].

(iv) Contribution towards pension scheme

Any sum paid by the assessee as an employer by way of contribution towards a pension scheme, as referred to in section 80CCD, on account of an employee to the extent it does not exceed ten per cent of the salary of the employee in the previous year.

Explanation. – For the purposes of this clause, "salary" includes dearness allowance, if the terms of employment so provide, but excludes all other allowances and perquisites;

(v) Approved Gratuity Fund

Any sum paid by the assessee as an employer by way of contribution to an approved gratuity fund created by him for the exclusive benefit of his employees under an irrevocable trust would be deductible as business expenditure (subject to section 43B). In the case of contributions to gratuity fund, normally the amount of contribution calculated on actuarial basis would be deductible although the liability to pay gratuity to employees may arise at a future point of time as and when the employee retires or dies.

(va) Deposit of the Employee's contribution by the Employer in relevant funds or or before date

Deduction is allowed to an assessee in respect of any sum received by him from any of his employees to which the provisions of sub-clause (x) of clause 24 of Section 2 apply i.e., Contribution to any provident fund, Superannuation fund, fund set-up under E.S.I. Act or any fund for welfare of employees, if such sum is credited by the assessee to the employee's account in the relevant fund or funds on or before the due date. "Due date" for the purposes of this clause means the date by which the assessee is required, as an employer to credit an employee's contribution to the employee's account in the relevant fund

under any Act, rule, order or notification issued thereunder or under any standing order, award, contract of service or otherwise.

Hence, the contributions received by an employer towards provident fund, an approved superannuation fund or any fund under the ESI Act or any other fund are allowed to an assessee as deduction only if such amount is “credited” by the employer to the employee’s account on or before the “due” date. The employer cannot, therefore, claim any deduction in respect of such accounts without “crediting” the employees’ account with the money. If the amount is not deposited in time then it will not be allowed as deduction and employer’s share will be treated as income.

(vi) Animals

In respect of animals, which have been used for purposes of the business or profession of the assessee otherwise than as stock-in-trade, a deduction would be allowable in the year in which the animals have died or have become permanently useless for the purpose of the business. The amount of allowance would be the difference between the actual cost of the animals to the assessee and the amount, if any, realised in respect of the carcasses of the animal.

(vii) (a) Bad Debts [Section 36 (1)(vii) and (2)]

The amount of any debt or part thereof which is written off as irrecoverable in the accounts of the assessee for the previous year is allowed to be deducted. The deduction for bad debt or part thereof has been taken into account in computing the income of the assessee of the previous year in which the amount of such debt or part thereof is written off or, of any earlier previous year, or, represents money lent in the ordinary course of the business of banking or money-lending which is carried on by the assessee. In this respect, the following conditions are pre-supposed:

1. Relationship of debtor and creditor

A bad debt pre-supposes the existence of a debt, and therefore, a relationship of debtor and creditor is essential. Unless there is an admitted debt and it becomes irrecoverable, it cannot be written off as a bad debt. *C.I.T. v. Vanguard Insurance Co. Ltd.* (1974) 97 ITR 546, 552 (Madras).

2. The debt must be incidental to the business or profession

The debt which is claimed as bad must be incidental to the business or profession carried on by the assessee. If the debt is not incidental to the business or profession, such a debt cannot be deducted as a bad debt. For example, in a solicitor’s profession, it is not a part of that profession to advance money to clients who may require financial help to purchase properties, farms or stocks. It is immaterial that the advance is made by a solicitor for the purposes of attracting clients and to induce them to remain with him. Any loss arising from such a lending is not deductible. On the other hand, payment of legal expenses of a law-suit under the client’s instruction is incidental to the profession. If any amount remains unrecovered in respect of such expenses, it can be allowed as a bad debt against the profits of the profession.

Similarly, where an assessee carries on business in an agricultural produce and has to advance money to growers under an agreement to have the advances adjusted towards the price of the produce to be delivered to the assessee, the losses incurred in the event of such advance becoming irrecoverable, arise out of the business and can be deducted as bad debt *C.I.T. v. Abdullakadar* (1961) 41 ITR 545, 551 (SC).

In the business of money-lending, each and every lending may not be in the ordinary course of business. For example, where a money-lender invests his capital or accumulated profits in government securities, mortgages and debentures and suffers a loss on the investment, such a

loss is capital loss and cannot be deducted as bad debt against the profits and gains of money-lending business. *Sir Chinubhai Madhaval v. C.I.T. (1937) 5 ITR 210 (Bom.)*. Debts due from retiring partners are capital sums and the loss of such amounts cannot be written off and claimed as bad debts. *Girdhari Lal Gian Chand v. C.I.T. (1971) 79 ITR 561 (All.)*.

3. Deduction in the year of writing off

No such deduction shall be allowed unless such debt or part thereof has been taken into account in computing the income of the assessee for the previous year in which the amount of such debt or part thereof is written off or of an earlier previous year, or represents money lent in the ordinary course of the business of banking or money-lending which is carried on by the assessee. The age of a debt is no doubt a relevant factor to be taken into consideration, but a time-barred debt is not necessarily bad: neither is a debt which is not time-barred necessarily good. *BCGA (Punjab) Ltd. v. C.I.T. (1937) 5 ITR 279*. A debt may have become time-barred but an assessee may not opt to claim it as bad if he relies on the honesty and integrity of the debtor. On the other hand, a debt may become bad even if it may not be time-barred. It is not necessary that a debt can be claimed as bad only if an assessee has failed to recover it through a court of law. Legal unenforceability of the claim does not prevent the amount from being a bad and irrecoverable debt for the purposes of taxation. *Badrinarayan Balkrishan v. C.I.T. (1968) 69 ITR 323 (A.P.)*. Taking into account the precarious and shaky financial position of the debtor, a creditor may opt not to institute legal proceedings and waste his good money after bad money. The assessee must satisfy the Assessing Officer that in fact the debt or the loan has become irrecoverable in the accounting year in which a claim for deduction is made in respect thereof and it has been written off from the book.

4. Adjustment in the year of recovery

The deduction in respect of a bad debt is based on a mere estimate. Therefore, if the amount of final recovery and the amount allowed as bad debt in respect of a bad debt falls short of the amount of such debt, such deficiency is further deductible in the year of final recovery. For example, an assessee claims a debt of ₹ 25,000 as bad in 1987-88. The Assessing Officer accepted a claim of ₹ 12,000 only. As a final settlement, the assessee recovered ₹ 8,000 in 1989-90 in respect of such debt. The amount of final recovery (₹ 12,000 + ₹ 8,000) falls short of the amount of the debt (i.e. ₹ 25,000). Such deficiency of ₹ 5,000 is deductible in the year in which the assessee writes it off in his books of account.

Conversely, if the amount of final recovery and the amount allowed as bad debt in respect of a debt exceed the amount of such debt, such excess is chargeable profit of the previous year in which such recovery is made [Section 41(4)]. It is immaterial whether the business or profession is in existence in such year or not. Continuing with the above example, if the amount of final recovery is ₹ 16,000, there is a taxable profit of ₹ 3,000 (₹ 16,000 + ₹ 12,000 - ₹ 25,000).

Note that recovery of bad debts is chargeable to tax as deemed profit [under Section 41(4)] if the recovery is made by the same person who got the allowance of the deduction. If the two entities are different the recovery of bad debt is not chargeable to tax [under Section 41(4)]. For example, a firm got the allowance of deduction in respect of bad debts. Subsequently, the firm is dissolved and it is taken over by one of the partners who recovers a part of the bad debt earlier allowed in the assessment of the firm. The partner is not assessable in respect of such recovery. *C.I.T. v. P.K. Kaimil (1980) 123 IRE 755 (Madras)*.

5. No allowance for bad debts of a discontinued business

No deduction is allowed for a bad debt of a business which has been discontinued before the commencement of the accounting year. Such a bad debt cannot be deducted from the profits of a separate existing business. *Kameshwar Singh v. C.I.T. (1947) 15 ITR 248*. An assessee can claim

the deduction for a bad debt of a business which is carried on by the assessee for at least sometime during the previous year. It is not necessary that the business should be carried on throughout the previous year.

6. Successor not entitled to write off predecessor's debts

The deduction of a bad debt can be claimed if the debt had been taken into account in computing the income of the assessee of that previous year or an earlier previous year unless it represents money lent in the ordinary course of the business of banking or money-lending which is carried on by the assessee. Therefore, the debts of a predecessor-in-business may not be deductible in the hands of a successor-in-business. Thus, where the entire business of a partnership, after retirement of one of the partners, was taken over by the other partner who continued with the same stock-in-trade, he is not entitled to claim a debt of the partnership as bad if the same is not realised. However, in certain cases even a successor is entitled to write off predecessor's debts. On dissolution of the firm, if one of the partners takes over the business with all assets and liabilities and carries it on as successor, he is entitled to allowance when a debt originally due to firm becomes bad. It is merely an incident flowing from the transfer of the business together with its assets and liabilities, from the previous owner to the transferee. It is a right which should, on a proper appreciation of all that is implied in a transfer of a business be regarded as belonging to the new owner. (*CIT v. T. Veerabhadra Rao, K. Koteswara Rao & Company (1985) 155 ITR 152 (SC)*).

If business is carried on without any break, change merely occurring in persons carrying on business would not disentitle business to claim deduction under this Section [*E.A.V. Krishnamurty & Son v. CIT (1985) 152 ITR 640 (Mad.)*].

7. No Deduction for provision for bad & doubtful debt:

Any bad debt or part thereof written off as irrecoverable in the accounts of the assessee shall not include any provision for bad and doubtful debts made in the accounts of the assessee. [Explanation 2 to section 36(1)(vii)]

(vii) (b) Provisions for bad and doubtful debts in case of Scheduled or non-scheduled Banks [Section 36(1)(vii) and (viiia)]

A scheduled bank or non-scheduled bank in India is allowed deduction in respect of provision made for bad and doubtful debts in accordance with the following provisions :

(i) Bank having no branch in rural area : The bank which have no branch in rural area shall be allowed deduction in respect of provision for bad and doubtful debts as follows :

- provision made for bad and doubtful debts
- 7.5% of gross total income

whichever is lower.

(ii) Bank having branch in rural area :

The following amount is allowed as deduction :

- (a) provision made for bad and doubtful debts or
- (b) (i) 7.5% of gross total income and
- (ii) 10.5% of the aggregate average advances made by the rural branch whichever is less

Average advances qualifying for the deduction will be computed in the following manner as per Rule 6ABA:

- (a) The amount of advances made by each rural branch as outstanding at the end of the last day of each month comprised in the previous year is to be aggregated separately.
- (b) The sum so arrived in case of each branch is to be divided by the number of months for which the outstanding advances have been taken into account for the purpose of clause (a).

(viii) Special reserves created by Financial Corporations

Special reserve created by financial corporation engaged in providing long-term finance for industrial or agricultural development in India or development of infrastructure in India or by a public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purpose, is deductible to the extent of 40% of income from such activity.

Condition to be fulfilled to get the above deduction:

- (i) The aggregate of the amounts carried to such reserve account from time to time do not exceed twice the amount of the paid-up share capital of the corporation, or the company and its general reserves.

In this clause –

- (a) “financial corporation” shall include a public company and a government company;
- (b) “public company” shall have the meaning assigned to it in Section 3 of the Companies Act, 1956; and
- (c) “government company” shall have the meaning assigned to it in Section 617 of the Companies Act, 1956.

In terms of Section 41(4A) any withdrawal from such special reserve would be deemed to be the profits and gains of business even if the business is closed down.

(ix) Expenditure on Family Planning

In the case of companies any bona fide expenditure incurred for the purpose of promoting family planning amongst the employees would be deductible. In cases where the expenditure is wholly or partly in the nature of a capital expenditure, the deduction allowable to the company in respect of the capital expenditure would be a sum equal to 1/5th in each year of the expenditure in respect of the accounting year in which it was actually incurred and 1/5th of each of the subsequent four years immediately following that year. The unabsorbed part of the capital expenditure on family planning incurred by the companies would be treated in the same way as unabsorbed capital expenditure on scientific research or unabsorbed depreciation and could be carried forward indefinitely without any time limit in cases where the profits of the assessee are not sufficient to cover the amount as allowable.

(x) Expenditure incurred by Corporation or a Body Corporate

Any expenditure which is not being in the nature of capital expenditure incurred by a corporation or a body corporate, by whatever name called, constituted or established by a Central, State or Provincial Act, is notified by the Central Government in the official Gazette and the expenditure incurred for the objects and purposes authorised by the Act under which such corporation or body corporate was constituted or established, is deductible.

(xi) Banking Cash Transaction Tax

Any amount of Banking Cash Transaction Tax paid by the assessee during the previous year on the taxable banking transactions entered into by him are allowed as deduction.

“Banking Cash Transaction Tax” and “Taxable Banking Transaction” shall have the same meanings respectively assigned to them under Chapter VII of the Finance Act, 2005;

- (xii) Any sum paid by a public financial institution by way of contribution to notified Credit Guarantee Fund Trust for small industries is allowed as deduction.

(xiii) Securities Transaction Tax

An amount equal to the securities transaction tax paid by the assessee in respect of the taxable securities transactions entered into in the course of his business during the previous year, if the income arising from such taxable securities transactions is included in the income computed under the head "Profits and gains of business or profession" is allowed as deduction.

"Securities Transaction Tax" and "Taxable Securities Transaction" shall have the meanings respectively assigned to them under Chapter VII of the Finance (No. 2) Act, 2004 (23 of 2004);

(xiv) Commodities Transaction Tax

An amount equal to the Commodities Transaction Tax paid by the assessee in respect of the taxable commodities transactions entered into in the course of his business during the previous year, if the income arising from such taxable commodities transactions is included in the income computed under the head "Profits and gains of business or profession" is allowed as deduction.

(V) Other Expenses not covered by the Previous Deductions

Section 37(1) of the Income-tax Act provides for allowance in respect of any other item of expenditure not covered by any of the provisions contained in Sections 30 to 36 discussed above. This deduction is subject to the following conditions:

- (i) The expenditure must have been laid out or expended by the assessee wholly and exclusively for the purposes of his business or profession.
- (ii) The expenditure should not be in the nature of a capital expenditure.
- (iii) The expenditure should not represent any item of personal expenditure of the assessee.
- (iv) The deduction claimed should not cover any of the items of the expenditure which are specifically disallowed under the Act.

Points for Consideration for Allowance of Expenditure as Deduction

- For the purpose of allowance of expenses under this section, it is not essential that the expenditure in question must necessarily have resulted in the earning of income or profits by the assessee.
- It is enough if the expenditure is incurred wholly and exclusively for the purposes of the business although it is not necessary for the assessee to prove that the expenditure is unavoidable or that the expenditure has been incurred out of business necessity.
- The assessee would be entitled to the allowance if he could prove that the expenditure is justified and has been incurred by reason of commercial expediency. Whether the particular expenditure is incurred in compliance with some other law for the time being in force or not the assessee would still be entitled to the deduction.
- Capital expenditure has been specifically disallowed by the provisions, care must be taken to ensure that a proper distinction is made between expenses of a capital nature and those of revenue nature because only revenue expenses would qualify for allowance under this section. The broad test is to determine whether the expenditure has resulted in the acquisition of a capital asset or property. To put it in other words, whether such expenditure has resulted in giving to the assessee a benefit of an enduring nature. The expression "enduring" used in this context should not be mistaken to mean ever-lasting or eternal nature but if the

benefit of an expenditure is so transitory or ephemeral as to be not in existence for some period the expenditure in question must be treated as being of a revenue nature.

- Care should also be taken to distinguish between expenses incurred for the purpose of the business to earn income and payments which are alleged to be expenses which, however, are really in the nature of diversion of profits.
- The allowability or otherwise of an item of expenditure under this section would be a question of facts and law and the ultimate conclusion would be the decision of the High Court or the Supreme Court, as the case may be.

For a detailed study of the various items of expenses which are allowable or disallowable under this section, students may refer suggested readings.

An explanation has been added by Finance (No. 2) Act, 1998 to clarify that any expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by Law shall not be allowed.

Some of the examples of allowable expenses under Section 37(1) are:

- (i) Expenditure incurred on raising loans or issuing debentures but not on issuing share capital.
- (ii) Legal expenses incurred:
 - (a) to avoid a business liability, e.g. for alleged breach of a trading contract;
 - (b) to defend the assessee's title to his assets, e.g. land, building, etc.;
 - (c) to secure the termination of a disadvantageous trading relationship, e.g. removal of an undesirable employee;
 - (d) by a director of a company in defending a suit brought to challenge the validity of his election to the directorship;
 - (e) to protect the capital asset of the business which has already been acquired;
 - (f) by a company in resisting a winding up petition by some shareholders;
 - (g) for defending monopoly rights;
 - (h) incurred in restraining another company from using assessee's trade mark.

However, the expenses incurred in criminal proceedings are not allowable. Legal expenses relating to acquisition of capital asset for a business are capital expenses and as such, not allowable.

In this connection the Supreme Court held that where litigation expenses are incurred by the assessee for the purpose of creating, curing or completing his title to the capital, then the expenses incurred must be considered as capital expenditure. But if the litigation expenses are incurred to protect the business of the assessee, they must be considered as a revenue expenditure. [*Dalmia Jain & Co. v. C.I.T. (1971) 81 ITR p. 754 (S.C.)*].

Expenditure for prosecuting civil proceedings is deductible provided the expenditure was laid out for the purpose of the business wholly and exclusively i.e. to promote the interest of the business. [*Sree Meenakshi Mills v. C.I.T. (1976) 63 ITR, p. 207 (S.C.)*]

- (iii) Bonus to employees under an industrial award.
- (iv) Expenses for the installation of new telephone.
- (v) Sales tax is an admissible deduction but not estate duty.
- (vi) Interest on unpaid purchase price of goods or capital assets.
- (vii) Expenditure incurred to oppose nationalization or to prevent extinction of business. However, the donations given for the political parties or for political cause are not admissible deductions under Section 37.

- (viii) Subscriptions given are allowed if their payment is compulsory or commercially expedient and of benefit to the payer.
- (ix) Expenses incurred on the occasion of festival or customary days are allowed up to a reasonable amount keeping in view the size of the business and subject to the satisfaction of the Assessing Officer that the expenses are not expenses of personal, social or religious nature.
- (x) Recurring expenses incurred on imparting basic training to apprentices under the Apprentices Act, 1961 is deductible.
- (xi) Initial expenditure on the first installation of fluorescent tube lights is treated as Capital expenditure and hence not deductible but all subsequent expenditure for replacement of tubes is treated as revenue expenditure and hence deductible.
- (xii) Loss through embezzlement by an employee is deductible.
- (xiii) Professional tax paid by a person carrying on business or trade is allowed as deduction.
- (xiv) Annual listing fee paid to stock exchange is allowed as deduction.
- (xv) Expenses incurred on Civil defence measures as specified by the Board, even when there is no emergency, is deductible.
- (xvi) Brokerage paid for raising loan to finance business.
- (xvii) Stamp and registration charges for the purpose of entering into agreement for obtaining overdraft facilities.
- (xviii) Security deposited with postal authorities for telex connection deductible as business expenditure. However, when the amount is returned by postal authorities, when the telex connection is finally closed, the refund shall be treated as an income of the assessee of the year in which the amount is refunded.
- (xix) Compensation payable as a result of negligence in carrying on a business or termination of an employee, director or agent.
- (xx) Compensation to an employee for injury sustained or accident met with while on duty.
- (xxi) Royalty paid for mining, patents or copyrights.
- (xxii) Insurance premiums: Premium for insurance of building, plant, machinery, furniture, stock or stores are allowable under specific sections, e.g., premium paid by a businessman under a policy insuring its employees or experts against death or injury, or insuring the employer against liability for compensation in respect of accidents to its workmen or against loss of trading licence.
- (xxiii) Penalty paid by the assessee for saving from confiscation of the goods which he has purchased from a third-party without knowing that they had been illegally imported.
- (xxiv) Pension, gratuity or other voluntary payment made to the employees are deductible but a gratuity paid to a single employee when it was not the practice of the business was treated as disallowable expense. In the same way voluntary pensions and lump sum payments made by a company to its employees on its winding up were not allowed.
- (xxv) Bona fide expenditure of a revenue nature incurred for the welfare of employees on its winding up was not allowed.
- (xxvi) Excessive price paid out of extra commercial considerations shall be disallowed.
- (xxvii) Sum paid by the assessee as a surety when it is not part of his business shall be disallowed.
- (xxviii) Presents given to employees by way of gift and not as perquisites for services rendered, shall be disallowed.

Section 37(2B) Advertisement Expenditure : Deduction is not available in respect of expenditure incurred by an assessee in any souvenir, tract, pamphlet or the like published by a political party.

Certain Allowable Losses

Losses which are directly incidental to the business or profession of the assessee are allowable. Following are some examples of such losses:

- (1) **Robbery or Dacoity:** Loss caused by robbery or dacoity is not deductible. But, if it is incidental to business it will be allowed as a deduction and this depends upon the specific circumstances and conditions. For example, if cash is sent for disbursement at different centers by a sugar factory in rural area, it is incidental to business and is, therefore, allowed. Any loss due to robbery in a bank will be allowed as the bank is under an obligation to maintain some cash outside the storeroom for payments.
- (2) **Embezzlement, Theft, etc.:** The loss of money due to embezzlement by an employee handling the funds of the business while discharging his official duties is allowed as deduction. It is deductible when discovered. When an employee goes to bank to deposit the cash or takes cash with him for disbursement and he takes away the money for his own use, even then, the loss is allowable. Theft by a cashier, who is incharge of cash is also an allowable loss. A theft committed either by an employee or by someone else by breaking open into the business premises after office hours, is also allowable.
- (3) **Loss due to Non-recovery of advances:** If it is the practice in a business to give advance money to the suppliers and if the supplier neither supplies the order nor refunds the advance money, the loss sustained by the assessee is incidental to business and is, therefore, allowable.

EXPENSES RESTRICTED/DISALLOWED (SECTION 40 AND SECTION 40A)

(a) Expenses Disallowed (Section 40)

The following amounts shall not be deducted in computing the income chargeable under the head "profits and gains of business or profession:

- (i) **Interest, royalty, fees for technical services payable outside India:** Under Section 40(a)(i), deduction is not allowed in respect of any interest (not being interest on a loan issued for public subscription before 1.4.1938), royalty, fees for technical services or other sum chargeable under the Income-tax Act, which is payable outside India or in India to a non-resident, not being a company or to a foreign company and on which tax has not been deducted or after deduction, has not been paid before the expiry of the time prescribed under Sub-section (1) of Section 200. In case where tax is paid or deducted in a subsequent year, the benefit of deduction from profit and gains from business and professional income will be allowed in computing the income of the previous year in which such tax has been paid.
- (ii) **TDS not deducted on certain payments:** Any interest, commission or brokerage, rent, royalty, fees for professional services or fees for technical services payable to a resident, or amounts payable to a contractor or sub-contractor, being resident, for carrying out any work (including supply of labour for carrying out any work), on which tax is deductible at source under Chapter XVIIB and such tax has not been deducted or, after deduction, has not been paid on or before the due date specified in sub-section (1) of section 139.

Provided that where in respect of any such sum, tax has been deducted in after the due date specified in sub-section (1) of section 139, such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.

Provided further that where an assessee fails to deduct the whole or any part of the tax in accordance with the provisions of Chapter XVII-B on any such sum but is not deemed to be an assessee in default

under the first proviso to sub-section (1) of section 201, then, for the purpose of this sub-clause, it shall be deemed that the assessee has deducted and paid the tax on such sum on the date of furnishing of return of income by the resident payee referred to in the said proviso.

(iii) Rate or Tax Paid on Profits: Under Section 40(a)(ii), any sum paid by the assessee on account of any tax or rate levied on profits on the basis of or in proportion to the profits and gains of any business or profession, would be disallowed in full. For example, income-tax, foreign income-tax or a professional tax levied under the Municipal Act on persons who exercise a profession, trade or calling within the municipal limit shall be disallowed.

Explanation 1 to sub-clause (ii) of clause (a) of Section 40 has been inserted to clarify that any sum paid outside India and eligible for relief of tax under Section 90 or deduction from the Income Tax payable under Section 91 is not allowable and deemed to have never been allowable as a deduction under Section 40 of the Income Tax Act. However, the tax payers will continue to be eligible for tax credit in respect of Income Tax paid in a foreign country in accordance with the provisions of Section 90 or Section 91 as the case may be.

Explanation 2 has been inserted w.e.f. 1.6.06 to provide that any sum paid outside India and eligible for relief of tax under new Section 90A will not be allowed as a deduction in computation of profit and gains from business or professions.

(iv) Wealth Tax [Section 40a(ii)]: Any wealth-tax paid or payable by the assessee in respect of his business assets would be totally disallowed. It is immaterial whether the wealth-tax is assessed and payable in India or in foreign country in respect of the business assets of the assessee.

However, any tax on business assets (other than wealth-tax) is deductible. [*Kawasaki Kissen Kaisha Ltd. v. C.I.T. (1975) 99 I.T.R. p. 7 (S.C.)*. Hence, tax paid on tea garden lands under U. P. Large Land Holding Tax Act, 1957 is deductible. [*Dehra Dun Tea Co. Ltd. v. C.I.T. (1973) 88 I.T.R. p. 197 (S.C.)*].

(v) Amount paid by way royalty, licence fee, service fee, privilege fee, service charge by State Government undertaking to State Government [Section 40(iib)]

Any amount

- (A) paid by way of royalty, licence fee, service fee, privilege fee, service charge or any other fee or charge, by whatever name called, which is levied exclusively on; or
- (B) which is appropriated, directly or indirectly, from, a State Government undertaking by the State Government.

In simple words, any amount paid by way of fee, charge, etc., which is levied exclusively on, or any amount appropriated, directly or indirectly, from a State Government undertaking, by the State Government, shall not be allowed as deduction for the purposes of computation of income of such undertakings under the head "Profits and gains of business or profession".

State Government undertaking includes –

- (i) a corporation established by or under any Act of the State Government;
- (ii) a company in which more than fifty per cent. of the paid-up equity share capital is held by the State Government;
- (iii) a company in which more than fifty per cent. of the paid-up equity share capital is held by the entity referred to in clause (i) or clause (ii) (whether singly or taken together);
- (iv) a company or corporation in which the State Government has the right to appoint the majority of the directors or to control the management or policy decisions, directly or indirectly, including by virtue

of its shareholding or management rights or shareholders agreements or voting agreements or in any other manner;

(v) *an authority, a board or an institution or a body established or constituted by or under any Act of the State Government or owned or controlled by the State Government.*

(vi) **Salaries [Section 40a(iii)]:** Any payment which is chargeable under the head "salaries" if it is payable –

- (A) outside India; or
- (B) to a non-resident

and if the tax has not been paid thereon or deducted thereon under Chapter XVIIB of the Act.

(vii) **Payment to Provident Funds etc. [Section 40a(iv)]:** Any payment to a Provident Fund or other fund established for the benefit of employees of the assessee would be disallowed in cases where the assessee (employer) has not made effective arrangements to secure deduction of tax at source from any payment made from the fund which are chargeable to tax under the head 'salaries' in the hands of the employees.

(viii) **Payment of tax on non-monetary perquisites [Section 40a(v)]:** Tax actually paid by an employer under Section 10(10CC) shall not be deducted in computing the income chargeable under the head "Profit and gains of business or profession".

(ix) **Payment to Partners:** The new provision of Section 40(b) which is substituted by the Finance Act, 1992 with effect from the assessment year 1993-94, provides as follows:

In the case of a firm which is assessable as such:

- (a) any payment of salary, bonus, commission or remuneration by whatever name called to a partner other than a working partner would not be allowed as deduction in the hands of the firm;
- (b) any remuneration paid to a working partner or interest paid to any partner, which is not authorised by or not in accordance with the terms of the partnership deed would not be allowable deduction in the hands of the firm;
- (c) any remuneration paid to a working partner or interest paid to any partner which is authorised by or is in accordance with the terms of the partnership deed but which relates to any period falling prior to the date of such partnership deed would not be allowable. However, in relation to any payment of remuneration to the partner during the previous year relevant to the assessment year 1993-94, the terms of the partnership may at any time during the said previous year, provide for such payment.
- (d) any interest which is paid in accordance with the terms of the partnership deed and relates to any period falling after the date of such partnership deed but which is in excess of simple interest @ 12% p.a., w.e.f. 1.6.2002 would not be allowable.

Further, interest paid by the firm to a person in his representative capacity (i.e. on behalf or for the benefit of any other person) and the interest paid by the firm to the person who is so represented shall also be subject to the limit laid down in this clause.

However, where a person is a partner in his representative capacity in the firm, the interest paid to him by the firm otherwise than as partner in a representative capacity will not be subject to the limit laid down in this clause. Again, where a person is a partner in a firm in his own capacity (and not as a partner in a representative capacity), interest paid by the firm to him shall not be taken into account for the purposes of this clause if such interest is received by him on behalf of or for the benefit of any other person.

- (e) any remuneration to a working partner which is authorised by and is in accordance with the terms of the partnership deed and in relation to any period falling after the date of partnership deed is an allowable deduction subject however, to the condition that the maximum amount of such payment made to all the partners during the previous year should not exceed the limits given below:

<i>Quantum of Book Profit</i>	<i>Amount</i>
(a) Upto ₹ 3,00,000 or in case of a loss	₹ 1,50,000 or 90% of the Book profit, whichever is more
(b) on the balance	60%

For the purposes of this clause, 'working partner' means an individual who is actively engaged in conducting the affairs of the business or profession of the firm of which he is a partner; and

'Book profit' means the net profit, as shown in the profit and loss account for the relevant previous year, computed in the manner laid down in chapter IV-D (i.e. Sections 28 to 44D) as increased by the aggregate amount of remuneration paid or payable to all the partners of the firm if such amount has been deducted while computing the net profit.

- (x) **Payment by AOPs / BOIs [Section 40(ba)]:** In the case of an association of persons or body of individuals (other than a company or a Co-operative Society or a society registered under the Societies Registration Act, 1860, or under any law corresponding to that Act in force in any part of India) any payment of interest, salary, bonus, commission or remuneration, by whatever name called, made by such association or body to a member of such association or body shall not be allowed as a deduction.

As per explanation 1 to clause (ba) of Section 40, where interest is paid by the association or body to any member thereof, who has also paid interest to the association or body, the disallowance shall be restricted to the amount paid by the association or body to the member, after deducting therefrom the amount paid by the member to the association or body.

Explanation 2 further specifies that in the case of a member in a representative capacity, the interest paid by the association or body to such a person in his individual capacity and not as in his representative capacity, shall not be taken into account. However, any interest paid to such person in his representative capacity shall be taken into account.

Where an individual is a member otherwise than as a member in a representative capacity of an AOP or BOI, interest paid to such person by the AOP or BOI shall not be taken into account for the purposes of this clause if such interest is received by the person on behalf of or for the benefit of any other person.

(b) Expenses Restricted

- (1) **Payment to Relatives or Associates [Section 40A(2)]:** Where the assessee incurs any expenditure in respect of which payment has been or is to be made to any person specified below and the Assessing Officer is of the opinion that such expenditure is excessive or unreasonable, having due regard to the fair market value of the goods, services or facilities for which the payment is made or the legitimate needs of the business or profession of the assessee or the benefit derived by or accruing to him therefrom, so much of the expenditure as is considered to be excessive or unreasonable must be disallowed in computing the assessee's income from business or profession.

However, no disallowance, on account of any expenditure being excessive or unreasonable having regard

to the fair market value, shall be made in respect of a specified domestic transaction referred to in section 92BA, if such transaction is at arm's length price as defined in clause (ii) of section 92F.

Meaning of specified domestic transaction (Section 92BA)

For the purposes of this section and sections 92, 92C, 92D and 92E, "specified domestic transaction" in case of an assessee means any of the following transactions, not being an international transaction, namely : –

- (i) any expenditure in respect of which payment has been made or is to be made to a person referred to in clause (b) of sub-section (2) of section 40A;
- (ii) any transaction referred to in section 80A;
- (iii) any transfer of goods or services referred to in sub-section (8) of section 80-IA;
- (iv) any business transacted between the assessee and other person as referred to in sub-section (10) of section 80-IA;
- (v) any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of sub-section (8) or sub-section (10) of section 80-IA are applicable; or
- (vi) any other transaction as may be prescribed,

and where the aggregate of such transactions entered into by the assessee in the previous year exceeds a sum of five crore rupees.

The specified persons, the payments to whom may fall for disallowance under this section are the following:

- (a) Where the assessee is an individual - any relative of the assessee.
- (b) Where the assessee is a company, firm, association of persons or H.U.F. any director of the company, partner of the firm, member of the association or family, or any relative of such director, partner or member.
- (c) Any individual who has a substantial interest in the business or profession of the assessee or any relative of such individual.
- (d) A company, firm, association of persons or H.U.F. having substantial interest in the business or profession of the assessee or any director, partner or member of such company, firm, association or family or any relative of such director, partner, or member as the case may be or any other company carrying on business or profession in which the first mentioned company has substantial interest.
- (e) A company, firm, association of persons or H.U.F. of which a director, partner or member, as the case may be, has substantial interest in the business or profession of the assessee or any director, partner or member of such company, firm, association or family or any relative of these persons.
- (f) Any person who carries on a business or profession in cases where the assessee is an individual or any relative of the individual or a person having substantial interest in the business or profession of that person or where the assessee is a company, firm, association of persons or H.U.F. any director of such company, partner of such firm, member of the association or family, or any of their relatives who has a substantial interest in the business or profession of that person.

For the purpose of this disallowance, a person must be deemed to have substantial interest in a business or profession - (i) in cases where the business or profession is carried on by a company, if such person is the beneficial owner at any time during the relevant accounting year of equity shares carrying not less than 20% of the total voting power, and (ii) in other cases, if such person is at any time

during the accounting year, beneficially entitled to not less than 20% of the profits of such business or profession.

(2) *Cash Payments exceeding ₹20,000 [(Section 40A(3)]:*

Where the assessee incurs any expenditure in respect of which a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, exceeds twenty thousand rupees, no deduction shall be allowed in respect of such expenditure.

Where an allowance has been made in the assessment for any year in respect of any liability incurred by the assessee for any expenditure and subsequently during any previous year (hereinafter referred to as subsequent year) the assessee makes payment in respect thereof, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, the payment so made shall be deemed to be the profits and gains of business or profession and accordingly chargeable to income-tax as income of the subsequent year if the payment or aggregate of payments made to a person in a day, exceeds twenty thousand rupees:

Provided that no disallowance shall be made and no payment shall be deemed to be the profits and gains of business or profession under sub-section (3) and this sub-section where a payment or aggregate of payments made to a person in a day, otherwise than by an account payee cheque drawn on a bank or account payee bank draft, exceeds twenty thousand rupees, in such cases and under such circumstances as may be prescribed, having regard to the nature and extent of banking facilities available, considerations of business expediency and other relevant factors.

Provided further that in the case of payment made for plying, hiring or leasing goods carriages, the amount shall not exceed thirty-five thousand rupees instead of twenty thousand rupees.

Under Rule 6DD of the Income-tax Rules, the following categories of payments are exempt for the purposes of this requirement. Consequently, the provisions of Section 40A(3) do not apply to the following cases and circumstances:

- (i) Payments which are made to the Reserve Bank of India, State Bank of India or other banking institutions, including co-operative banks and land mortgage banks, primary credit societies, Life Insurance Corporation of India, Unit Trust of India and certain specified institute providing Industrial Finance.
- (ii) Payments, which under the contracts entered into prior to 1.4.1969 have to be made only in legal tender.
- (iii) Payments made to the Central or State Governments which under the Rules framed by the Government are required to be made in legal tender.
- (iv) Payments in villages and towns having no banking facility, to persons ordinarily residing or carrying on business or profession in such villages or towns.
- (v) Payments by means of book adjustment by the assessee in the account of the payee against money due to the assessee for any goods supplied or services rendered by him to the payee.
- (vi) Payments made by any Letter of Credit arrangement through bank, a mail or telegraphic transfer through bank, a book adjustment from any account in a bank to any other account in that or any other bank and a bill of exchange made payable only to a bank.
- (vii) Payments of terminal benefits such as gratuity, retrenchment compensation, etc. not exceeding ₹ 50,000.

- (viii) Payments made to cultivators, growers or producers for the purchase of agricultural or forest produce, animal husbandry products including hides and skins, products of dairy or poultry farming, products of horticulture or fish, products of cottage industry run without the aid of power.
- (ix) Where the payment is made to an employee temporarily but for a minimum period of fifteen days in a place other than his normal place of duty or on a ship provided tax has been deducted at source in terms of Section 192 of the Act and provided further that such employee has no bank account at such place of temporary posting or ship.
- (x) Where the payment was required to be made on a day on which the banks were closed either on account of holiday or strike.
- (xi) Where payment is made to an agent who in turn is required to make payment in cash for goods or services on behalf of the assessee.

(3) Provision for Gratuity [Section 40A(7)]: No deduction shall be allowed in respect of any provision made by the assessee for the payment of gratuity to his employees on their retirement or termination of their employment for any reason. However, any provision made by the assessee for the payment of a sum by way of any contribution towards an approved gratuity fund or for the purpose of payment of any gratuity that has become payable during the previous year shall be allowed.

Where any provision made by the assessee for the payment of gratuity to his employees on their retirement or termination of their employment for any reason has been allowed as a deduction in computing the income of the assessee for any assessment year, any sum paid out of such provision by way of contribution towards an approved gratuity fund or by way of gratuity to any employee shall not be allowed as a deduction in computing the income of the assessee of the previous year in which the sum is so paid.

(4) Restriction on contribution by employers to non-statutory funds [Sections 40A(9), (10) and (11)]:

With a view to discouraging creation of irrevocable or discretionary trusts funds, companies, associations of persons, societies, etc. the Finance Act, 1984 has provided that no deduction shall be allowed in the computation of taxable profits in respect of any sums paid by the assessee as an employer towards the setting up or formation of or as contribution to any fund, trust, company, association of persons, body of individuals or society or any other institution for any purpose, except where such sum is paid by the assessee as an employer towards the setting up or formation of or as contribution to any fund, trust, company, association of persons, body of individuals or society or any other institution for any purpose, except where such sum is paid or contributed (within the limits laid down under the relevant provisions) to a recognised provident fund or an approved gratuity fund or an approved superannuation fund or for the purposes of and to the extent required by or under any other law.

It is further provided that where the Assessing Officer, is satisfied that the fund, trust, company, association of persons, body of individuals, society or other institution referred above has, before March 1, 1984 bona fide laid out or expended any expenditure (not being in the nature of capital expenditure) wholly or exclusively for the welfare of the employees of the assessee out of the sum referred above, the amount of such expenditure shall, in case no deduction has been allowed to the assessee in respect of such sum, be deducted in computing the business income of the assessee of the previous year in which such expenditure is so laid out or expended. It is also provided that where the assessee has before March 1, 1984, paid any sum to any fund, trust, company, association of persons, body of individuals, society or other institutions, then notwithstanding anything contained in any other law or in any instrument, he would be entitled:

- (a) to claim the unutilised amount be repaid to him and where any claim is so made, the unutilised amount shall be repaid, as soon as may be, to him; and
- (b) to claim that land, building, machinery, plant and furniture acquired or constructed by the fund, trust, company, association of persons, body of individuals, society or other institution out of the sum paid by

the assessee, be transferred to him and where any claim is so made, such asset shall be transferred, as soon as may be to him.

The aforesaid provisions took effect retrospectively from 1st April, 1980, and accordingly, apply in relation to the assessment year 1980-81 and subsequent years.

(c) Disallowance of unpaid statutory liability (Section 43B)

Under the income-tax law, a person carrying on a business or profession can account for his income either on cash or mercantile basis. The latter, however, have to reckon with the restrictions contained in Section 43B. This section cuts into the freedom of a business to claim certain specified expenses on due basis. The section has broadly divided the targeted expenses into two i.e., according to section 43B even if an assessee maintains books on mercantile system then he will be allowed exemption of the following expenses only on payment basis. In the first category are:

- (a) taxes, duties, cess or fees payable under any law;
- (b) bonus and commission to employees;
- (c) interest to public financial institutions, state financial corporations, state industrial investment corporations and to scheduled banks in respect of term loans or advances;
- (d) leave encashment.
- (e) any sum payable by employer by way of contribution to provident fund or super annuation fund or any other fund for welfare of employees.

These four sets of expenses outstanding at the end of the previous year would be allowed as deduction only to the extent they have been actually paid on or before the due date of filing the income-tax return failing which they would be allowed in the previous year they have been actually paid. Where interest as stipulated in (d) above is converted into a loan, borrowing or advance and is not paid, interest so converted will not be treated as having been actually paid, and accordingly, will not be allowed as a deduction from business income.

The second category deals with employers' contribution to provident fund superannuation fund, gratuity fund or any other fund for the welfare of employees. No deduction on this account shall be allowed unless payment is made to the appropriate authority like the Provident Commissioner in case of PF contribution on or before the due date set out in the relevant statute like the PF Act. In case the payment was made otherwise than by cash, the sum should have been realised within 15 days of such due date. For example, if PF contributions are to be handed over to the relevant authority within a month from the end of the month in which it was deducted from employees' salary and the employer for the month of August '99 deductions makes the payment say in the month of October '99, he will lose the benefit of deduction in so far as contributions to PF for the month of August '99 are concerned.

However, Finance Act, 2003 has omitted the second proviso and therefore PF and ESI contribution will be allowed as deduction even if they are not paid within due date specified under relevant Acts.

DEEMED PROFITS

Section 41 of the Income-tax Act enumerates items of notional income which are deemed to be income from business or profession chargeable to tax. The liability to tax in respect of deemed profits would arise not only during the existence of the business but also after its discontinuance. The items of deemed profits are enlisted below:

- (i) **Remission of Liability or Recoupment of Loss or Expenditure:** Where any allowance or deduction has been made in the assessment for any year in respect of losses, expenditure or trading liability incurred by the assessee and subsequently the assessee or his/its successor in business has obtained,

whether in cash or in any other manner whatsoever, any amount in respect of such loss or expenditure or some benefit in respect of such trading liability by way of remission or cessation thereof during any subsequent accounting year, the amount so obtained or the value of the benefit so accruing to the assessee or his/its successor in business as the case may be, must be deemed to be the profits and gains of business or profession and must be charged to tax as the income of the assessee or his/its successor in business as the case may be for the year in which the remission or cessation takes place. This tax liability would arise irrespective of the fact whether the business or profession in respect of which the allowance or deduction has been made is being continued to be carried on by the assessee in the year of remission of liability or not. For instance, if sales tax is paid by the assessee in the year 1998-99 and the assessee gets a refund of sales-tax previously paid in the year 1999-2000, the refund would be taxable as the assessee's income of 1999-2000. But the taxability of any deemed profit on account of remission of liability or recoupment of loss would arise only if the liability in question or the amount of the loss was previously allowed as a deduction in computing the business income of the assessee. For instance, if the income-tax assessment for the year in which the expenditure or loss was claimed was made ex parte or was a best judgement assessment and the income was estimated, it cannot be said that the expenditure was actually allowed as a deduction in the assessment. Consequently, if there is a remission of the liability subsequently, the assessee cannot be brought to charge in respect of the same. The Finance (No. 2) Act, 1996 has clarified that unilateral write back of any liability would be taxable as deemed income.

“Successor in business” means –

- (i) *in case of amalgamation of companies the amalgamated company;*
 - (ii) *where the first mentioned person is succeeded by any other person in that business or profession, the other person;*
 - (iii) *where a firm carrying on business or profession is succeeded by another firm, the other firm;*
 - (iv) *where there has been a demerger, the resulting company.*
- (ii) **Where any building, machinery plant or furniture owned by the assessee** and used for the purpose of business for which depreciation under Section 32(1)(i) is claimed, is sold, discarded, demolished or destroyed and the money payable together with scrap value in respect of such assets exceeds the written down value, the excess to the extent of difference between the actual cost and the written down value shall be taxable as business income in the previous year in which the moneys payable become due.

Even if in the year the moneys payable becomes due, the business for which these assets were used is no longer in existence, the provisions of this section shall apply as if the business is in existence in that previous year.

- (iii) **Capital expenditure on Scientific Research:** Where an assessee incurs capital expenditure on scientific research, the entire amount of such expenditure is allowable as a deduction in computing the business income of the assessee in the same year in which the expenditure is incurred. If subsequent to the incurring of the expenditure, the asset representing the capital expenditure is sold, without having been used for other purposes, the assessee would be liable to pay tax on the excess of sale proceeds together with the deduction allowed earlier over the amount of capital expenditure or the amount of deduction allowed earlier whichever is less.

Further, the assessee is liable to pay tax on the balancing charge even if the assessee's business is not in existence during the previous year in which the money payable in respect of any asset becomes due.

Explanation: For the purpose of Sub-section (3) –

- (1) "moneys payable in respect of any building, machinery, plant or furniture" includes -
- (a) any insurance, salvage or compensation moneys payable in respect thereof;
 - (b) where the building, machinery, plant or furniture is sold, the price for which it is sold, so however, that where the actual cost of a motor car is, in accordance with the proviso to clause (1) of Section 43, taken to be twenty-five thousand rupees, the moneys payable in respect of such motor car shall be taken to be a sum which bears to the amount for which the motor car is sold or, as the case may be, the amount of any insurance, salvage or compensation moneys payable in respect thereof (including the amount of scrap value, if any) the same proportion as the amount of twenty-five thousand rupees bears to the actual cost of the motor car to the assessee as it would have been computed before applying the said proviso;
- (2) "sold" includes a transfer by way of exchange or a compulsory acquisition under any law for the time being in force but does not include a transfer, in a scheme of amalgamation, of any asset by the amalgamating company to the amalgamated company where the amalgamated company is an Indian Company.
- (iv) **Recovery of Bad Debts:** Where the assessee claims a deduction in any year in respect of a debt which has become bad or irrecoverable and the Assessing Officer allows a deduction to the extent of the bad debts, if subsequently the assessee recovers either the full amount of the debt which was previously written off as bad or part thereof, the amount so recovered would be chargeable to tax as the business income of the assessee in the year of recovery. But if the amount claimed by the assessee as bad debt was previously disallowed by the Assessing Officer on the ground that it had not actually become bad or it was not written off by the assessee, when the money is recovered, there would be no liability to tax in respect thereof. In cases where the Assessing Officer had allowed only a part thereof as bad, in the subsequent year of recovery, the tax liability under this section must be on the amount of difference between the amount recovered and the bad debt disallowed by the Assessing Officer.
- (v) **Withdrawal of any amount from special reserve:** Where a deduction has been allowed in respect of any special reserve created and maintained under clauses (viii) of Sub-section (1) of Section 36 any amount subsequently withdrawn from such special reserve shall be deemed to be the profits and gains of business or profession and accordingly be chargeable to income tax as the income of the previous year in which such amount is withdrawn.
- Where any amount is withdrawn from the special reserve in a previous year in which the business is no longer in existence, the provisions of this sub-section shall apply as if the business is in existence in that previous year.
- (vi) **Set off of Losses of a Defunct Business against Deemed Profit:** Where the business or profession referred to in this section is no longer in existence and there is income chargeable to tax under points (i), (ii), (iv) and (v) given above in respect of that business or profession, any loss, not being a loss sustained in speculation business, which arose in that business or profession during the previous year in which it ceased to exist and which could not be set off against any other income of that previous year shall as far as may be, be set off against the income chargeable to tax under the sub-section aforesaid.

SPECIAL PROVISION FOR DEDUCTIONS IN THE CASE OF BUSINESS FOR PROSPECTING ETC. FOR MINERAL OIL (SECTION 42)

For the purpose of computing the profits and gains of any business of prospecting for or the extraction or production of mineral oils in relation to which the Central Government has entered into an agreement with any person for the association or participation in such business of the Central Government, the assessee is entitled to an allowance over and above the various items of allowances and deductions permissible under the Income-

tax Act. The additional allowance in this regard would be in relation to the expenditure incurred by the assessee by way of infructuous or abortive exploration expenses in respect of any area surrendered prior to the beginning of commercial production by the assessee. Where the expenditure is incurred after the beginning of commercial production, the special allowance would relate to the expenditure incurred by the assessee, whether before or after such commercial production, in respect of drilling or exploration activities or services or in respect of physical assets used in that connection [except those assets which qualify for depreciation allowance under Section 32 only in those cases where the agreement is entered into before 31st Day of March, 1981]. Further, expenditure incurred in relation to the depletion of mineral oil in the mining area in respect of assessment year relevant to the accounting year in which commercial production is begun and such succeeding year as may be specified in the agreement between the Central Government and the assessee would also qualify for this allowance. The amount of this special allowance must be computed in the manner specified in the agreement and wherever necessary the other provisions of the Income-tax Act would, for this purpose, be deemed to have been modified to the extent necessary for giving effect to the terms of the agreement. For the purposes of this section, 'mineral oil', includes petroleum and natural gas.

Section 42 has been amended, with effect from the assessment year 1999-2000 to provide that subject to the provisions of the agreement entered into by the Central Government, where the business of assessee consisting of the prospecting for or extraction or production of petroleum and natural gas is transferred or any interest therein is transferred, wholly or partly, and the proceeds of the transfer are less than the expenditure incurred remaining unallowed, a deduction equal to the expenditure remaining unallowed as reduced by the proceeds of transfer, shall be allowed in respect of the previous year, in which the business or an interest therein has been transferred. Where such business or any interest therein is transferred and proceeds of the transfer exceed the amount of expenditure incurred remaining unallowed, the excess amount shall be chargeable to tax as profits and gains of business in the previous year in which such business or interest therein has been transferred. No deduction shall be allowed in the previous year in which the business or any interest therein is transferred in case the proceeds of transfer are not less than the expenditure remaining unallowed.

Where in a scheme of amalgamation or demerger, the amalgamating or the demerged company sells or otherwise transfers the business to the amalgamated or the resulting company (being an Indian company) the provisions of this sub-section shall not apply to amalgamating or demerged company. Instead they will apply to the amalgamated or the resulting company as they would have applied to the amalgamating or the demerged company if the latter had not transferred the business or interest in the business.

SPECIAL PROVISIONS CONSEQUENTIAL TO THE CHANGES IN THE RATE OF EXCHANGE OF CURRENCY [Section 43A]

Section 43A of the Income-tax Act contains special provisions to provide for additional allowance to the assessee in respect of capital assets whose actual cost is affected by the changes in the rate of exchange of currency. These provisions are to be taken into account in all cases where an assessee has acquired any depreciable asset from any country outside India for the purposes of his business or profession and as a result of a change in the rate of exchange at any time subsequent to the date of its acquisition by the assessee, there is an increase or reduction in the liability of the assessee in terms of Indian Rupees for making payment towards the whole or part of the cost of the asset or for payment of the whole or part of the moneys borrowed by him from any person directly or indirectly in any foreign currency specifically for the purpose of acquiring the capital asset. The amount by which the liability of the assessee in terms of Indian Rupees is increased or reduced as a result of change in the rate of exchange of the currency, would be added to or as the case may be deducted from the actual cost of the asset as defined in Section 43(1). Consequently, the amounts of depreciation allowable to assessee in respect of the asset would correspondingly be increased or reduced, as the case may be. This provision for changes in the rate of exchange of currency resulting in the increase or reduction in the deduction allowable in respect of actual cost of the asset would apply in respect of capital expenditure on scientific research, capital expenditure incurred for acquisition of patents and copyrights, capital expenditure incurred by companies

for promoting family planning amongst their employees and capital expenditure incurred for acquiring a capital asset, the cost of which under Section 48 has to be ascertained for the purpose of determining the amount of capital gains. The assessee would not, however, be entitled to any increase or reduction in the amount of development rebate allowed or allowable to him on the basis of the revised actual cost of the asset.

For these purposes, the expression 'rate of exchange' must be taken to mean the rate of exchange determined or recognised by the Central Government for the conversion of Indian Rupee into foreign currency or vice-versa. In cases where the whole or part of the liability in respect of the payment for the cost of the asset or in respect of the money borrowed from a foreign source for acquiring the capital asset is met not by the assessee but directly or indirectly by any other person or authority, the liability so met by the other persons should not be taken into account for the purposes of any adjustment in the actual cost of the asset and consequently the depreciation allowable to the assessee arising from the change in the rate of exchange of the currency. If, at the time of change in the rate of exchange arising on account of devaluation or otherwise the actual cost of the asset has been fully paid by the assessee and no money remains outstanding in respect of any sum borrowed specifically for the purpose, no adjustment would be permissible to the assessee. The special provision would, however, apply only in respect of capital expenditure or the value of the capital asset and would not in any way affect the value of the current assets, such as stock-in-trade or other trading assets.

Section 43A of the Income-tax Act, 1961 has been amended by the Finance Act, 2002, w.e.f. Assessment Year 2003-04, providing that where a capital asset has been acquired from a foreign country, the addition or deduction from the actual cost of the asset on account of change in the rate of exchange in any previous year shall be allowed to be made only on actual payment by the assessee towards the cost of the asset or repayment of the foreign loan or interest, irrespective of the method of accounting adopted by him.

But, where an addition to or deduction from the actual cost or expenditure or cost of acquisition has been made under this section, under old provision, on account of an increase or reduction in the liability as aforesaid, the amount to be added to, or, as the case may be, deducted under this section from, the actual cost or expenditure or cost of acquisition at the time of making the payment shall be so adjusted that the total amount added to, or, as the case may be, deducted from, the actual cost or expenditure or cost of acquisition, is equal to the increase or reduction in the aforesaid liability taken into account at the time of making payment.

SPECIAL PROVISION FOR COMPUTATION OF COST OF ACQUISITION OF CERTAIN ASSETS (SECTION 43C)

Where an asset [other than those referred to in Section 45(2)] which becomes the property of an amalgamated company under a scheme of amalgamation, is sold after February 29, 1988 as stock in trade the cost of acquisition of the asset to the amalgamated company shall be the cost of acquisition of the asset to the amalgamating company as increased by the cost, if any, of any improvement made thereto and the expenditure if any, incurred wholly and exclusively in connection with such transfer.

Where an asset [other than those referred to in Section 45(2)] which becomes the property of the assessee on the total or partial partition of a HUF or under a gift or will or an irrevocable trust is sold after February 29, 1988, as stock in trade, then, in computing the profits and gains from sale of such assets, the cost of acquisition of the said asset to the assessee shall be the cost of acquisition of the said asset to the transferor or the donor, as the case may be, as increased by the cost, if any, incurred wholly and exclusively in connection with such transfer, including the payment of gift-tax, if any, incurred by the transferor or the donor, as the case may be.

COMPUTATION OF INCOME UNDER THE HEAD "PROFITS AND GAINS OF BUSINESS OR PROFESSION" FOR TRANSFER OF IMMOVABLE PROPERTY IN CERTAIN CASES (SECTION 43CA)

Currently, when a capital asset, being immovable property, is transferred for a consideration which is less than the value adopted, assessed or assessable by any authority of a State Government for the purpose of payment of stamp duty in respect of such transfer, then such value (stamp duty value) is taken as full value of consideration

under section 50C of the Income-tax Act. These provisions do not apply to transfer of immovable property, held by the transferor as stock-in-trade.

This section has been inserted with effect from assessment year 2014-15 where the consideration for the transfer of an asset (other than capital asset), being land or building or both, is less than the stamp duty value, the value so adopted or assessed or assessable by any authority of state government for the purpose of payment of stamp duty in respect of such transfer the value so adopted or assessed or assessable shall for the purpose of computing income under the head "Profits and gains of business of profession" shall be deemed to be the full value of the consideration received or accruing as a result of such transfer.

Where the date of an agreement fixing the value of consideration for the transfer of the asset and the date of registration of the transfer of the asset are not same, the stamp duty value may be taken as on the date of the agreement for transfer and not as on the date of registration for such transfer.

However, this exception shall apply only in those cases where amount of consideration or a part thereof for the transfer has been received by any mode other than cash on or before the date of the agreement.

SPECIAL PROVISION IN CASE OF INCOME OF PUBLIC FINANCIAL INSTITUTIONS, ETC. (SECTION 43D)

Section 43D has been inserted by Finance (No. 2) Act, 1991 w.e.f. 1.4.1991. This section provides that in the case of a public financial institution or a scheduled bank or a state financial corporation or a state industrial investment corporation, the income by way of interest on such categories of bad and doubtful debts as may be prescribed having regard to the guidelines issued by the Reserve Bank of India in relation to such debts shall be chargeable to tax in the previous year in which it is credited to profit and loss account by such institution referred above for that year or in the previous year in which it is actually received by them whichever is earlier.

With a view to improve the viability of leasing finance companies, the section has been amended to provide that in case of a public company, the income by way of interest in relation to such categories of bad and doubtful debts as may be prescribed having regard to the guidelines issued by the National Housing Bank established under the National Housing Bank Act, 1987 in relation to such debt shall be chargeable to tax in the previous year in which it is credited to the profit and loss account by the said public company for that year or in the previous year in which it is actually received by it, whichever is earlier.

INSURANCE BUSINESS (SECTION 44)

The profits and gains of any business of insurance must, according to Section 44, be computed in accordance with the rules contained in the First Schedule to the Income-tax Act. For the purpose of the computation, it is immaterial whether the insurance business is carried on by mutual insurance company or by a co-operative society or by any other person. The rules contained in the Schedule would apply notwithstanding anything to the contrary contained in the provisions of the Income-tax Act relating to the computation of income chargeable under the head 'Interest on Securities', 'income from house property', 'capital gains', or 'income from other sources' or under the head 'income from business or profession'.

SPECIAL PROVISIONS FOR DEDUCTION IN CASE OF TRADE, PROFESSIONAL OR SIMILAR ASSOCIATIONS (SECTION 44A)

Section 44A of the Income-tax Act provides for a special deduction in the case of any trade, professional or similar association which is not exempt from Income-tax under Section 10(23A). This deduction is allowable in cases where the amount received during the accounting year by the trade, professional or other associations from its members, whether by way of subscription or otherwise, falls short of the expenditure actually incurred by such association during that accounting year solely for the purpose of protection or advancement of the common interest of the members. Moneys received by way of remuneration for running any specific services to

the members would not, however, be treated as forming part of income of the association for this purpose. Consequently, in calculating the amount of deficiency, these receipts would be taken into account and would be allowed as deduction so as to reduce the amount of deficiency. Similarly, capital expenditure and also expenditure deductible in computing the income of the assessee under any other provision of the Act, would not be taken into account in determining the amount of deficiency. The amount of deficiency would be allowable as a deduction in computing the income of the association assessable for the relevant assessment year under the head 'profits and gains from business or profession'. If there is no income assessable under this head or the amount of deficiency allowable to the assessee exceeds the income under this head, the whole or the balance of the amount of deficiency, as the case may be, shall be allowed as a deduction in computing the income of the association assessable for that assessment year under any other head. The amount of deficiency shall not, however, be allowed to be carried forward for any subsequent year.

The amount of deficiency to be allowed as deduction under Section 44A should not, in any case, exceed 50% of the total income of the association computed before making any allowance under this section. This section, however, applies only to that trade, professional or other similar associations, the income of which or any part thereof is not distributed to its members except as grants to any institution or association affiliated to it. In computing the income of the association for the relevant assessment year in which the deficiency falls allowable, the other provisions of the Act granting deductions and allowances must be given effect to before the deficiency under this section could be allowed. Likewise, losses from any earlier year which are brought forward and qualify for being set off, must be allowed to be set off before the deficiency under this section is sought to be allowed as deduction.

MAINTENANCE OF ACCOUNTS (SECTION 44AA)

The following persons are liable to maintain such books of accounts and other documents as may enable the Assessing Officer to compute the total income in accordance with the provisions of this Act:

- (i) Every person carrying on legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or any other profession as is notified by the Board [i.e. authorised representative or film artist].
- (ii) Every person who is carrying on business or profession [not being profession referred to in point (i) above] and whose income from business or profession exceeds ₹ 1,20,000 or the total sales, turnover or gross receipts exceeds ₹10,00,000 in any one of the three years immediately preceding the previous year.
- (iii) In case of a newly set up business or profession in the previous year, if his income from business or profession is likely to exceed ₹ 1,20,000 or total sales, turnover or gross receipts are likely to exceed ₹ 10,00,000, during such previous year.
- (iv) Where profits and gains from business are deemed to be profits and gains under section 44AE or Section 44BB or Section 44BBB and assessee has claimed his income to be lower than the profits and gains then such profits and gains shall be deemed to be profits and gains of his business during the previous year or
- (v) where the profits and gains from the business are deemed to be the profits and gains of the assessee under section 44AD and he has claimed such income to be lower than the profits and gains so deemed to be the profits and gains of his business and his income exceeds the maximum amount which is not chargeable to income-tax during such previous year.

Under presumptive assessment under sections mentioned above, if assessee claims that his income is lower than that specified under these sections, assessee is required to get his accounts audited by a Chartered Accountant and copy of that report needs to be attached alongwith his return of income. Therefore to get his

accounts audited he needs to maintain such books to substantiate his claim and also to enable Chartered Accountant to issue Audit Report to this effect.

For details students may refer to Rule 6F also for specified books to be maintained.

COMPULSORY AUDIT OF ACCOUNTS OF CERTAIN PERSONS CARRYING ON BUSINESS OR PROFESSION (SECTION 44AB)

Section 44AB makes it obligatory for

1. a person to get his accounts audited before the 'specified date' by an 'accountant' if the total sales, turnover or gross receipts in business for the previous year exceed or exceeds ₹1 crore or
2. a person carrying on profession will also have to get his accounts audited before the specified date, if his gross receipts in profession for a previous year or years relevant to any of the aforesaid assessment years exceed ₹25 lakhs.

The provision also casts an obligation on such persons to furnish by the 'specified date' a report of the audit in the prescribed form duly signed and verified by the accountant setting forth such particulars as may be prescribed by rules made in this behalf by the Central Board of Direct Taxes. In cases where accounts are required to be audited by or under any other law, it will suffice if the accounts are audited under such other law before the specified date and the assessee furnishes by that the said date the report of the audit as required under such other law.

Where profits and gains from business are deemed to be profits and gains under section 44AE or Section 44BB or Section 44BBB as the case may be and assessee has claimed his income to be lower than the profits and gains then such profits and gains shall be deemed to be profits and gains of his business during the previous year or

Assessee carrying on the business shall, if the profits and gains from the business are deemed to be the profits and gains of such person under section 44AD and he has claimed such income to be lower than the profits and gains so deemed to be the profits and gains of his business and his income exceeds the maximum amount which is not chargeable to income-tax in any previous year

Under presumptive assessment under sections mentioned above, if assessee claims that his income is lower than that specified under these sections, assessee is required to get his accounts audited by a Chartered Accountant and copy of that report needs to be attached alongwith his return of income. Therefore to get his accounts audited he needs to maintain such books to substantiate his claim and also to enable Chartered Accountant to issue Audit Report to this effect.

However, as amended by the Finance Act, 1992, the provision of this section of compulsory audit shall not apply to those assessees who derive income under Section 44BBA on and from April 1, 1985 or, as the case may be, the date on which the relevant section came into force, whichever is later.

The term 'accountant' will have the same meaning as in the explanation to Sub-section (2) of Section 288 of the Income-tax Act and the term "Specified date", in relation to the accounts of the assessee of the previous year relevant to an assessment year means the 31st day of October of the assessment year.

According to Section 271B, if any person fails without reasonable cause to get his accounts audited in respect of any previous year or years relevant to an assessment year or to furnish a report of such audit as required under the aforesaid provision, or furnish the said report along with the return of his income, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum equal to 1/2% of total sales, turnover or gross receipts, as the case may be, in the business, or the gross receipts in the profession of such previous year or years, subject to a maximum of ₹ 1.5 lakh.

SPECIAL PROVISION FOR COMPUTING PROFITS AND GAINS OF BUSINESS ON PRESUMPTIVE BASIS (SECTION 44AD)

The provisions of this section shall be applicable on any business except the business of plying, hiring or leasing goods carriages referred to in section 44AE and whose total turnover or gross receipts in the previous year does not exceed an amount of one crore. This section is inserted by Finance Act, 2009 for providing relief to all the small businesses from maintaining the books of accounts and to reduce the compliance and administrative burden.

- This section will cover an individual, Hindu undivided family or a partnership firm, other than Limited Liability Partnership firm and who has not claimed deduction under any of the sections 10A, 10AA, 10B, 10BA or deduction under any provisions of Chapter VIA.
- A sum equal to eight per cent of the total turnover or gross receipts of the assessee in the previous year shall be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession" further the assessee have the option to claim a sum higher than eight per cent of the total turnover or gross receipts.
- No deduction shall be allowed to the assessee under sections 30 to 38 however the salary and interest paid to the partners shall be allowed for deduction subject to the conditions and limits specified in section 40(b)
- The written down value of any asset of an eligible business shall be deemed to have been calculated as if the eligible assessee had claimed and had been actually allowed the deduction in respect of the depreciation for each of the relevant assessment years.
- where the assessee claims that his profits and gains from the business are lower than the profits and gains on presumptive basis and whose total income exceeds the maximum amount which is not chargeable to income-tax, shall be required to keep and maintain such books of account and other documents as required under section 44AA and get them audited and furnish a report of such audit as required under section 44AB.
- The provisions of this section, notwithstanding anything contained in the foregoing provisions, shall not apply to –
 - (i) a person carrying on profession as referred to in sub-section (1) of section 44AA;
 - (ii) a person earning income in the nature of commission or brokerage; or
 - (iii) a person carrying on any agency business.

It means that section 44AA and 44AB shall be applicable only if assessee does not opt for presumptive taxation and his total income exceeds the taxable limit.

SPECIAL PROVISIONS FOR COMPUTING PROFITS AND GAINS OF BUSINESS OF PLYING, HIRING OR LEASING GOODS CARRIAGES (SECTION 44AE)

Section 44AE provides for a system for estimating the income of an assessee engaged in the business of plying, hiring or leasing of goods carriages. The scheme is applicable to an assessee who owns not more than ten goods carriages at any time during the previous year and who is engaged in the business of plying, hiring or leasing of such goods carriages. The profits and gains of each goods carriage shall be estimated as under:

- (i) ₹5,000 for every month or part of a month in case of a heavy goods vehicle;
- (ii) ₹4,500 for every month or part of a month in case of other goods vehicle.

The assessee may however declare a higher income.

Any deduction allowable under the provisions of Sections 30 to 38 shall, for the purposes of the above income, be deemed to have been already given full effect to and no further deduction under these sections shall be allowed.

Remuneration and interest paid/payable to partners, shall be allowed as deduction from the income computed under this Section. Such deduction shall however be subject to the conditions and limits specified under Section 40(b).

The written down value of any asset used for the purpose of the business shall be deemed to have been calculated as if the assessee had claimed and had been actually allowed the deduction in respect of the depreciation for each of the relevant assessment year.

The assessee is neither required to maintain books of accounts under the provisions of Section 44AA, nor required to get his accounts audited under the provisions of Section 44AB in respect of his income from such business. However, for other business (if any) he will have to comply with the Sections 44AA and 44AB.

Income from such business as estimated will be aggregated with other incomes of the assessee from other businesses or other heads of income and all deductions under Sections 80CCC to 80U will be available to the assessee on fulfillment of the requisite conditions of those sections.

If the assessee claims and produces evidence to prove that profits and gains from such business during assessment year 1997-98 or earlier years is lower than the estimate of profits as per this section, the Assessing Officer shall make assessment of such income under Section 143(3) and determine the sum payable by the assessee on the basis of such assessment.

With effect from assessment year 1998-99 the section has been amended to provide that an assessee can claim his income to be lower than the estimate as per this section. However, in that case he will have to keep books of accounts and other documents as per Section 44AA and will have to get his accounts audited irrespective of the turnover under Section 44AB.

SPECIAL PROVISIONS FOR COMPUTING PROFITS AND GAINS OF SHIPPING BUSINESS IN THE CASE OF NON-RESIDENTS (SECTION 44B)

In the case of a non-resident assessee, engaged in the business of operation of ships, a sum equal to 7-1/2% of the aggregate of the following amounts shall be deemed to be the profits and gains of such business chargeable to tax under the head 'profits and gains of business or profession':

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

SPECIAL PROVISION FOR COMPUTING PROFITS AND GAINS IN CONNECTION WITH THE BUSINESS OF EXPLORATION ETC., OF MINERAL OILS (SECTION 44BB)

(1) Notwithstanding anything to the contrary contained in Sections 28 to 41 and Sections 43 and 43A, in the case of an assessee being a non-resident engaged in the business of providing services or facilities in connection with, or supplying plant and machinery on hire used, or to be used, in the prospecting for, or extraction or production of, mineral oils, a sum equal to ten per cent of the aggregate of the amounts specified in Sub-section (2) shall be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession".

Provided that Section 44BB(1) shall not apply in a case where provisions of Section 42 or Section 44D or section 44DA or Section 115A or Section 293A apply for the purposes of computing profits or gains or any other income referred to in those sections.

(2) The amounts referred to in Sub-section (1) shall be the following, namely:

- (i) the amount paid or payable (whether in India or outside) to the assessee or to any person on his behalf on account of the provision of services and facilities in connection with, or supply of plant and machinery on hire used or to be used in the prospecting for, or extraction or production of mineral oil in India; and
- (ii) the amount received or deemed to be received in India, by or on behalf of the assessee on account of the provision of services and facilities in connection with, or supply of plant and machinery on hire used or to be used in the prospecting for, or extraction or production of, mineral oils outside India.

(3) Notwithstanding anything contained in Sub-section (1), an assessee may claim lower profits and gains than the profits and gains specified in that Sub-section, if he keeps and maintains such books of account and other documents as required under Sub-section (2) of Section 44AA and gets his accounts audited and furnishes a report of such audit as required under Section 44AB, and thereupon the Assessing Officer shall proceed to make an assessment of the total income or loss of the assessee under Sub-section (3) of Section 143 and determine the sum payable by, or refundable to, the assessee."

Explanation: For the purposes of this section –

- (i) "plant" includes ships, aircraft vehicles, drilling units, scientific apparatus and equipment, used for the purposes of the said business;
- (ii) "mineral oil" includes petroleum and natural gas.

SPECIAL PROVISION FOR COMPUTING PROFITS AND GAINS OF THE BUSINESS OF OPERATION OF AIRCRAFT IN THE CASE OF NON-RESIDENTS (SECTION 44BBA)

(1) Notwithstanding anything to the contrary contained in Sections 28 to 43A, in the case of an assessee, being a non-resident, engaged in the business of operation of aircraft, a sum equal to five per cent of the aggregate of the amounts specified in Sub-section (2) shall be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession".

(2) The amounts referred to in Sub-section (1) shall be the following, namely:

- (i) the amount paid or payable (whether in or out of India) to the assessee or to any person on his behalf on account of the carriage of passengers, livestock, mail or goods from any place in India; and
- (ii) the amount received or deemed to be received in India, by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods from any place outside India.

SPECIAL PROVISION FOR COMPUTING PROFITS AND GAINS OF FOREIGN COMPANIES ENGAGED IN THE BUSINESS OF CIVIL CONSTRUCTION ETC. IN CERTAIN TURNKEY POWER PROJECTS [SECTION 44BBB]

(1) Where a foreign company is engaged in the business of civil construction or the business of erection of plant or machinery or testing or commissioning thereof, in connection with a turnkey power project approved by the Central Government and financed under any international aid programme, ten per cent of the amount paid or payable, whether in or out of India, to the said assessee or any person on his behalf on account of such assignment shall be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession".

(2) Notwithstanding anything contained in Sub-section (1), an assessee may claim lower profits and gains than the profits and gains specified in that Sub-section, if he keeps and maintains such books of account and other documents as required under Sub-section (2) of Section 44AA and gets his accounts audited and furnishes a report of such audit as required under Section 44AB, and thereupon the Assessing Officer shall proceed to make an assessment of the total income or loss of the assessee under Sub-section (3) of Section 143 and determine the sum payable by, or refundable to, the assessee.

DEDUCTION OF HEAD OFFICE EXPENDITURE IN THE CASE OF NON-RESIDENTS (SECTION 44C)

A non-resident shall be allowed expenditure in the nature of head office expenditure to the extent of least of:

- (a) an amount equal to 5% of the adjusted total income; or
- (b) the amount of so much of the expenditure in the nature of head office expenditure incurred by the assessee as is attributable to the business or profession of the assessee in India.

Where the adjusted total income of the assessee is a loss, the amount shall be computed at the rate of 5% of the average adjusted total income of the assessee.

Adjusted total income means, the total income computed under the provisions of this Act but without giving effect to the following:

- (i) allowance referred to in this section;
- (ii) unabsorbed depreciation [Section 32(2)];
- (iii) investment allowance [Section 32A];
- (iv) development rebate [Section 33];
- (v) development allowance [Section 33A];
- (vi) family planning expenses incurred by a company [Section 36(1)(ix)];
- (vii) carried forward business loss [Section 72(1)];
- (viii) carried forward speculation loss [Section 73(2)];
- (ix) carried forward capital loss [Section 74(1) and (3)];
- (x) carried forward loss from horse race [Section 74A(3)];
- (xi) deductions from gross total income under Chapter VIA [i.e. under Sections 80C to 80U].

'Average adjusted total income' means the average total income of the assessee of the three assessment years immediately preceding the relevant assessment year or for lesser period if the assessee is assessable for that period, as the case may be.

'Head office expenditure' means executive and general administration expenditure incurred by the assessee outside India including expenditure incurred in respect of:

- (i) rent, rates, taxes, repairs, insurance of any premises outside India used for the purpose of business or profession;
- (ii) salaries, wages, annuity, pension, fees, bonus, commission, gratuity, perquisites or profits in lieu of or in addition to salary paid or allowed to any employee or other persons employed in, or managing the affairs of any office outside India;
- (iii) travelling expenses of the person mentioned in (ii); and
- (iv) such other matters connected with executive and general administration as may be prescribed.

COMPUTATION OF INCOME BY WAY OF ROYALTY ETC. IN CASE OF FOREIGN COMPANIES (SECTION 44DA)

In case of a foreign company, the deduction admissible in computing the income by way of royalty or fees for technical service received from government or an Indian concern in pursuance of an agreement made by it with the government or an Indian concern before 1.4.1976 shall not exceed in the aggregate 20% of the gross

amount of such royalty or fees as reduced by so much of the gross amount of such royalty as consists of lump sum consideration for the transfer outside India or the imparting of information outside India in respect of any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process or trade mark or similar property. However, no deduction under any of the sections (Sections 28 to 44C) shall be allowed in computing the income by way of royalty or fees for technical services received from government or an Indian concern in pursuance of an agreement made by the foreign company with the Indian concern after 31.3.1976 but before the 1st day of April, 2003.

No deduction in respect of any expenditure or allowance shall be allowed under any of the said sections (Sections 28 to 44C) in computing income by way of interest received from Government or an Indian concern on moneys borrowed or debt incurred by the Government or the Indian concern in foreign currency.

Further the provisions of section 44BB shall not apply in respect of the income referred to in this section.

Illustration:

Advise an assessee about the admissibility or otherwise of the claims, with regard to the following items, giving reasons:

- (a) Compensation paid to an employee for premature termination of his services.
- (b) Amount spent in a successful suit filed against another for infringing the assessee's trademark.
- (c) Penalty paid to customs authorities for importing prohibited goods which yielded a large margin of profits.
- (d) Travelling expenses of a director who went to Europe for negotiating the purchase of a new heavy machinery which was eventually installed next year.
- (e) Cost of erecting a medical annexe to the factory for the emergency treatment of the employees.
- (f) Lump-sum consideration paid for acquiring know-how ₹ 6,00,000.
- (g) Loss of ₹ 1,000 which were snatched away from the khazanhee's possession while going to bank to deposit the amount.
- (h) Loss due to embezzlement by an employee.
- (i) Brokerage paid for raising loan for the business.
- (j) ₹ 1,000 spent in connection with installation of a new telephone connection.
- (k) Fees paid to lawyer for drafting the Deed of Agreement with an outsider relating to the setting-up the business.
- (l) Pension paid to the widow and children of a deceased engineer of the factory voluntarily.
- (m) Interest paid for funds borrowed specifically for the acquisition of a capital asset.

Solution:

- (a) Assuming that the termination of the services of an employee was in the interest of the business, this item will be treated as an admissible expenditure.
- (b) It is admissible as the expenditure has been incurred to maintain an asset (viz., the trademark).
- (c) Penalty paid for illegal activities of the assessee are not to be allowed as expenditure under the Income Tax Act.
- (d) It is inadmissible as it is incurred for the acquisition of a new asset.

- (e) It is not an admissible expenditure, being of a capital nature. However, depreciation can be claimed u/s 32(1).
- (f) On the cost of know-how depreciation shall be allowed @ 25% on W.D.V. basis u/s 32(1).
- (g) This loss is admissible as it was part of his duty to carry cash for depositing it in bank and hence it is incidental to the business.
- (h) It is admissible as it has been sustained during the ordinary course of business.
- (i) Brokerage paid for raising a loan for the business is an admissible expenditure.
- (j) It is an admissible deduction under executive instruction.
- (k) It is not admissible as it is in the nature of capital expenditure, but 1/5th of it will be allowed under Section 35D for five successive previous years.
- (l) Pension paid to the widow and children of a deceased engineer is not allowed as deduction as it is not an obligatory expenditure in connection with the business.
- (m) Interest paid for funds borrowed specifically for the acquisition of a capital asset is allowable u/s 36(1)(iii) as it is incurred for the purpose of the business.

Illustration:

From the following Profit and Loss Account of a Merchant for the year ending 31st March, 2014. Compute his income from business and his total income for assessment year 2014-15:

Profit and Loss Account

	₹		₹
To Trade expenses	700	By Gross Profit	35,200
To Salary	2,500	By Dividend from a	
To Rent, Rates and Taxes	2,400	Cooperative Society	3,000
To Income-tax	1,400	By Income from Property	850
To Discount and allowance	300	By Interest from Government	
To Household expenses	2,000	Securities (gross)	2,000
To Life Insurance Premium	1,000		
To Interest on Capital	500		
To Interest on loan	700		
To Advertisement	800		
To Postage and Telegram	50		
To Audit Fee	200		
To Provision for gratuity	4,000		
To Fire Insurance Premium	730		
To Provision for bad debts	2,000		
To Provision for Income-tax	1,800		
To Depreciation	4,000		
To Net Profit	15,970		
	41,050		41,050

Solution:*Computation of Total Income for the Assessment Year 2014-15*

	₹	₹
Income from house property:		
– Income from property	850	
Less: 30% under Section 24	(255)	
Income from house property	595	
Income under the head Business or Profession		
Net Profit	15,970	
<i>Add: Inadmissible items:</i>		
– Income tax	1,400	
– Household Expenses	2,000	
– Life Insurance Premium	1,000	
– Interest on Capital	500	
– Provision for gratuity	4,000	
– Provision for bad debts	2,000	
– Provision for Income-tax	<u>1,800</u>	
<i>Less: Income to be shown separately:</i>		
– Dividends from a cooperative society	3,000	
– Income from property	850	
– Interest from Government Securities	<u>2,000</u>	
Taxable Profits from Business	22,820	
Income from other sources:		
Dividends from cooperative society	3,000	
Interest from Government Securities	<u>2,000</u>	
Income from other sources	<u>5,000</u>	
Gross Total Income:		<u>28,415</u>

Notes:

1. Provision for gratuity is not admissible. However, payment of actual gratuity is allowed.
2. It is assumed that income from property is by way of rent received and as per the provision of Section 24 of the Act, thirty percent thereof has been deducted as repair allowance.

Illustration

Following particulars are supplied by a textile unit situated in Mumbai for the assessment year 2014-15:

Block of Assets	WDV as on 1.4.2012	Additions	Sale	Rate of Dep.
1	2	3	4	5
Factory building	20,50,000	8,00,000 (completed on 15.1.2014)	—	10%
Residential buildings	50,00,000	5,00,000 (completed on 31.7.2013)	—	5%
Plant and Machinery	90,00,000	3,00,000 (on 5.10.2013)	11,00,000	15%
Furniture and fittings	10,30,000	1,00,000 (on 10.10.2013)	3,50,000	10%

You are required to calculate the amount of allowable depreciation under the Income-tax Act, 1961.

Solution:**Computation of Depreciation**

<i>Factory Building</i>	₹	@	Amount (₹)
WDV as on 01.04.2013	20,50,000	10%	2,05,000
Addition on 15.01.2014	8,00,000	50% of 10%	40,000
			2,45,000
<i>Residential Building</i>			
WDV as on 1.4.2013	50,00,000	5%	2,50,000
Addition as on 31.7.2013	5,00,000	5%	25,000
			2,75,000
<i>Plant and Machinery</i>			
WDV as on 1.4.2013	90,00,000		
Less: Sale	(11,00,000)		
	79,00,000	15%	11,85,000
Addition as on 5.10.2013	3,00,000	50% of 15%	22,500
Additional depreciation on new investment		20% of 3,00,000	60,000
			12,67,500
<i>Furniture</i>			
WDV as on 1.4.2013	10,30,000		
Less: Sale	(3,50,000)		

	6,80,000	10%	68,000
Addition as on 10.10.2013	1,00,000	50% of 10%	5,000
			73,000

Note: In the case of assets which are put to use in the business for a period of less than 180 days, the depreciation permissible is @ 50% of the normal rate.

Illustration

Net profit as per profit and loss account of X is ₹ 6,86,000 for the year ending 31st March, 2014. The following information is noted from his accounts:

- (a) Advertisement expenditure debited to profit and loss account include the following:
 - (i) Expenditure incurred outside India: ₹ 46,000 (permitted by RBI);
 - (ii) Articles presented by way of advertisement (60 articles cost of each being ₹ 900; and 36 articles cost of each being ₹ 1,700);
 - (iii) ₹ 16,000 being cost of advertisement which appeared in a newspaper owned by a political party;
 - (iv) ₹ 11,400 being capital expenditure on advertisement;
 - (v) ₹ 12,000 paid in cash; and
 - (vi) ₹ 7,000 paid to a concern in which X has substantial interest (amount is excessive to the extent of ₹ 1,400).
- (b) Out of salary to employees of ₹ 8,70,000 debited to the profit and loss account:
 - (i) ₹ 40,000 is employees' contribution to recognised provident fund, ₹37,500 of which is credited in the employees' account in the relevant fund before the 'due date';
 - (ii) ₹ 46,000 is bonus which is paid on 13th November, 2014;
 - (iii) ₹ 36,000 is commission which is paid on 1st December, 2014;
 - (iv) ₹ 20,000 is incentive to workers which is paid on 10th December, 2014;
 - (v) ₹ 40,000 is paid outside India in respect of which tax is not deducted at source;
 - (vi) ₹ 6,000 being capital expenditure for promoting family planning amongst employees; and
 - (vii) ₹ 40,000 being entertainment allowance given to employees.
- (c) Entertainment expenditure debited to profit and loss account is ₹ 9,000.

Determine the net income of X for the assessment year 2014-15.

Solution:

Calculation of Net Income of X for assessment year 2014-15

	₹
Net Profit as per Profit and Loss Account	6,86,000
Add: Inadmissible items:	
Cost of advertisement which appeared in a newspaper owned by a political party	16,000
Excessive amount paid to a concern in	

which X has substantial interest	1,400
Employee contribution to recognised provident fund (to the extent not credited in the employees' account in the relevant fund before the 'due date')	2,500
Bonus being paid to employees after the 'due date' of filing the return	46,000
Commission being paid to employees after the 'due date' of filing the return	36,000
Salary paid outside India in respect of which tax is not deducted at source	40,000
Capital expenditure for promoting family planning amongst employees (allowed only to a corporate assessee)	6,000
Capital expenditure on Advertisements	11,400
Net Income	1,59,300
	8,45,300

Notes :

1. Restrictions on advertisement and entertainment abolished.
2. With the abolition of Section 37(3), which inter alia governed the deductibility of advertising expenses, advertising too has come within the fold of the omnibus Section 37(1) which specifically frowns on capital expenditure. The Himachal Pradesh High Court verdict in Mohan Meakin Breweries Ltd. v. CIT (1979) 118 ITR 101 allowing capital expenditure on advertising therefore has ceased to have the force of law as it was rendered in the context of Section 37(3).
3. Advertisement expenses of ₹ 12,000 (i.e. within the limit of ₹ 20,000) is paid in cash, hence admissible.
4. The 'due date' for filing return where the assessee is a person (other than a company) who is required to get his accounts audited under the Income-tax Act or any other law is September 30; and where the assessee is a person deriving income from business and who is not required to get his accounts audited, the 'due date' is July, 31.

Under the provisions of Section 43B of the Act - Bonus ₹ 46,000 paid on 13th Nov., 2014 and Commission ₹ 36,000 paid on 1st Dec., 2013 are not admissible since the payments are made after the above mentioned 'due date'.

5. Incentive to workers which is paid on 10th December, 2014 is admissible on 'due basis'.

Rates at which Depreciation shall be allowable from Assessment Year 2006-2007 Onwards

APPENDIX I

[See rule 5]

Table of Rates at which Depreciation is Admissible

(iv) New commercial vehicle which is acquired on or after the 1st day of October, 1998, but before the 1st day of April, 1999 in replacement of condemned vehicle of over 15 years of age and is put to use for any period before the 1st day of April, 1999 for the purposes of business or profession in accordance with the third proviso to clause (ii) of sub-section (1) of section 32 [see Note 6 below the Table]	60
(v) New commercial vehicle which is acquired on or after the 1st day of April, 1999 but before the 1st day of April, 2000 in replacement of condemned vehicle of over 15 years of age and is put to use before the 1st day of April, 2000 for the purpose of business or profession in accordance with the second proviso to clause (ii) of sub-section (1) of section 32 [see Note 6 below the Table]	60
(vi) New commercial vehicle which is acquired on or after the 1st day of April, 2001 but before the 1st day of April, 2002 and is put to use before the 1st day of April, 2002 for the purposes of business or profession [see Note 6 below the Table]	50
(vii) Moulds used in rubber and plastic goods factories	30
(viii) Air pollution control equipment, being –	100
(a) Electrostatic precipitation systems	
(b) Felt-filter systems	
(c) Dust collector systems	
(d) Scrubber-counter current/venturi/packed-bed/ cyclonic scrubbers	
(e) Ash handling system and evacuation system	
(ix) Water pollution control equipment, being—	100
(a) Mechanical screen systems.	
(b) Aerated detritus chambers (including air compressor)	
(c) Mechanically skimmed oil and grease removal systems	
(d) Chemical feed systems and flash mixing equipment	
(e) Mechanical flocculators and mechanical reactors	
(f) Diffused air/mechanically aerated activated sludge systems	
(g) Aerated lagoon systems	
(h) Biofilters	
(i) Methane-recovery anaerobic digester systems	
(j) Air floatation systems	
(k) Air/steam stripping systems	
(l) Urea Hydrolysis systems	
(m) Marine outfall systems	

(n) Centrifuge for dewatering sludge	
(o) Rotating biological contractor or bio-disc	
(p) Ion exchange resin column	
(q) Activated carbon column	
(x) (a) Solidwaste, control equipments being, caustic/ lime/chrome/ mineral/cryolite recovery system	100
(b) Solidwaste recycling and resource recovery systems	
(xi) Machinery and plant, used in semi-conductor industry covering all integrated circuits (ICs) (excluding hybrid integrated circuits) ranging from small scale integration (SSI) to large scale integration/very large scale integration (LSI/VSLI) as also discrete semi-conductor devices such as diodes, transistors, thyristors, triacs, etc., other than those covered by entries (viii), (ix) and (x) of this sub-item and sub-item (8) below.	30
(xia) Life saving medical equipment, being –	40
(a) D.C. Defibrillators for internal use and pace makers	
(b) Haemodialysors	
(c) Heart Lung Machine	
(d) Cobalt Therapy Unit	
(e) Colour Doppler	
(f) SPECT Gamma Camera	
(g) Vascular Angiography System including Digital subtraction Angiography	
(h) Ventilator used with anaesthesia apparatus	
(i) Magnetic Resonance Imaging System	
(j) Surgical Laser	
(k) Ventilators other than those used with anaesthesia	
(l) Gamma knife	
(m) Bone Marrow Transplant Equipment including silastic long standing intravenous catheters for chemotherapy	
(n) Fibre optic endoscopes including, Paediatric resectoscope/audit resectoscope, Peritoneo-scopes, Arthroscope, Microlaryngoscope, Fibreoptic Flexible Nasal Pharyngo Bronchoscope, Fibreoptic Flexible Laryngo Bronchoscope, Video Laryngo Bronchoscope and Video Oesophago Gastroscope, Stroboscope, Fibreoptic Flexible Oesophago Gastroscope	
(o) Laparoscope (single incision)	
(4) Containers made of glass or plastic used as re-fills	50

(5) Computers including computer software [see Note 7 below the Table]	60
(6) Machinery and plant, used in weaving, processing and garment sector of textile industry, which is purchased under TUFS on or after the 1st day of April, 2001 but before the 1st day of April, 2004 and is put to use before the 1st day of April, 2004 [see Note 8 below the Table]	50
(7) Machinery and plant, acquired and installed on or after the 1st day of September, 2002 in a water supply project or a water treatment system and which is put to use for the purpose of business of providing infrastructure facility under clause (i) of sub-section (4) of section 80-IA [see Notes 4 and 9 below the Table]	100
(8) (i) Wooden parts used in artificial silk manufacturing machinery	100
(ii) Cinematograph films – bulbs of studio lights	100
(iii) Match factories – wooden match frames	100
(iv) Mines and quarries:	100
(a) Tubs, winding ropes, haulage ropes and sand stowing pipes	
(b) Safety lamps	
(v) Salt works – Salt pans, reservoirs and condensers, etc., made of earthy, sandy or clayey material or any other similar material	100
(vi) Flour mills – Rollers	80
(vii) Iron and steel industry – Rolling mill rolls	80
(viii) Sugar works – Rollers	80
(ix) Energy saving devices, being –	
A. Specialised boilers and furnaces:	
(a) Ignifluid/fluidized bed boilers	
(b) Flameless furnaces and continuous pusher type furnaces	
(c) Fluidized bed type heat treatment furnaces	80
(d) High efficiency boilers (thermal efficiency higher than 75 per cent in case of coal fired and 80 per cent in case of oil/ gas fired boilers)	
B. Instrumentation and monitoring system for monitoring energy flows:	
(a) Automatic electrical load monitoring systems	
(b) Digital heat loss meters	
(c) Micro-processor based control systems	
(d) Infra-red thermography	80
(e) Meters for measuring heat losses, furnace oil flow, steam flow, electric energy and power factor meters	
(f) Maximum demand indicator and clamp on power meters	

(g) Exhaust gases analyser	
(h) Fuel oil pump test bench	
C. Waste heat recovery equipment	
(a) Economizers and feeds water heaters	
(b) Recuperates and air pre-heaters	80
(c) Heat pumps	
(d) Thermal energy wheel for high and low temperature waste heat recovery	
D. Co-generation systems:	
(a) Back pressure pass out, controlled extraction, extraction-cum-condensing turbines for co-generation along with pressure boilers	
(b) Vapour absorption refrigeration systems	80
(c) Organic rankine cycle power systems	
(d) Low inlet pressure small steam turbines	
E. Electrical equipment:	
(a) Shunt capacitors and synchronous condenser systems	
(b) Automatic power cut off devices (relays) mounted on individual motors	
(c) Automatic voltage controller	
(d) Power factor controller for AC motors	
(e) Solid state devices for controlling motor speeds	80
(f) Thermally energy-efficient stenters (which require 800 or less kilocalories of heat to evaporate one kilogram of water)	
(g) Series compensation equipment	
(h) Flexible AC Transmission (FACT) devices – Thyristor controlled series compensation equipment	
(i) Time of Day (TOD) energy meters	
(j) Equipment to establish transmission highways for National Power Grid to facilitate transfer of surplus power of one region to the deficient region	
(k) Remote terminal units/intelligent electronic devices, computer hardware/ software, router/bridges, other required equipment and associated communication systems for supervisory control and data acquisition systems, energy management systems and distribution management systems for power transmission systems	
(l) Special energy meters for Availability Based Tariff (ABT)	

F. Burners:	
(a) 0 to 10 per cent excess air burners	
(b) Emulsion burners	80
(c) Burners using air with high pre-heat temperature (above 300oC)	
G. Other equipment:	
(a) Wet air oxidation equipment for recovery of chemicals and heat	
(b) Mechanical vapour recompressors	
(c) Thin film evaporators	80
(d) Automatic micro-processor based load demand controllers	
(e) Coal based producer gas plants	
(f) Fluid drives and fluid couplings	
(g) Turbo charges/super-charges	
(h) Sealed radiation sources for radiation processing plants	
(x) Gas cylinders including valves and regulators	60
(xi) Glass manufacturing concerns – Direct fire glass melting furnaces	60
(xii) Mineral oil concerns:	60
(a) Plant used in field operations (above ground) distribution – Returnable packages	
(b) Plant used in field operations (below ground), but not including kerbside pumps including under ground tanks and fittings used in field operations (distribution) by mineral oil concerns	
(xiii) Renewable energy devices being:	80
(a) Flat plate solar collectors	
(b) Concentrating and pipe type solar collectors	
(c) Solar cookers	
(d) Solar water heaters and systems	
(e) Air/gas/fluid heating systems	
(f) Solar crop drivers and systems	
(g) Solar refrigeration, cold storages and air conditioning systems	
(h) Solar steels and desalination systems	
(i) Solar power generating systems	
(j) Solar pumps based on solar-thermal and solar-photovoltaic conversion	
(k) Solar-photovoltaic modules and panels for water pumping and other applications	80

(l) Wind mills and any specially designed devices which run on wind mills	
(m) Any special devices including electric generators and pumps running on wind energy	
(n) Biogas-plant and biogas-engines	
(o) Electrically operated vehicles including battery powered or fuel-cell powered vehicles	
(p) Agricultural and municipal waste conversion devices producing energy	
(q) Equipment for utilising ocean waste and thermal energy	
(r) Machinery and plant used in the manufacture of any of the above sub-items	
(9) (i) Books owned by assessees carrying on a profession:	
(a) Books, being annual publications	100
(b) Books, other than those covered by entry (a) above	60
(ii) Books owned by assessees carrying on business in running lending libraries	100
IV. SHIPS	
(1) Ocean-going ships including dredgers, lugs, barges, survey launches and other similar ships used mainly for dredging purposes and fishing vessels with wooden hull	20
(2) Vessels ordinarily operating on inland waters, not covered by sub-item (3) below	20
(3) Vessels ordinarily operating on inland waters being speed boats [see Note 10 below the Table]	20
PART B INTANGIBLE ASSETS	
Know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature	25

Notes:

1. "Buildings" include roads, bridges, culverts, wells and tubewells.
2. A building shall be deemed to be a building used mainly for residential purposes, if the built-up floor area thereof used for residential purposes is not less than sixty-six and two-third per cent of its total built-up floor area and shall include any such building in the factory premises.
3. In respect of any structure or work by way of renovation or improvement in or in relation to a building referred to in Explanation 1 of clause (ii) of sub-section (1) of section 32, the percentage to be applied will be the percentage specified against sub-item (1) or (2) of item I percentage to be applied will be the percentage specified against sub-item (1) or (2) of item I as may be appropriate to the class of building in or in relation to which the renovation or improvement is effected. Where the structure is constructed or the work is done by way of extension of any such building, the percentage to be applied would be such percentage as would be appropriate, as if the structure or work constituted a separate building.

4. Water treatment system includes system for desalination, demineralisation and purification of water.
5. "Electrical fittings" include electrical wiring, switches, sockets, other fittings and fans, etc.
6. "Commercial vehicle" means "heavy goods vehicle", "heavy passenger motor vehicle", "light motor vehicle", "medium goods vehicle" and "medium passenger motor vehicle" but does not include "maxi-cab", "motor-cab", "tractor" and "road-roller". The expressions "heavy goods vehicle", "heavy passenger motor vehicle", "light motor vehicle", "medium goods vehicle", "medium passenger motor vehicle", "maxi-cab", "motor-cab", "tractor" and "road-roller" shall have the meanings respectively as assigned to them in section 2 of the Motor Vehicles Act, 1988 (59 of 1988).
7. "Computer software" means any computer programme recorded on any disc, tape, perforated media or other information storage device.
8. "TUFS" means Technology Upgradation Fund Scheme announced by the Government of India in the form of a Resolution of the Ministry of Textiles vide No. 28/1/99-CTI of 31.3.1999.
9. Machinery and plant includes pipes needed for delivery from the source of supply of raw water to the plant and from the plant to the storage facility.
10. "Speed boat" means a motor boat driven by a high speed internal combustion engine capable of propelling the boat at a speed exceeding 24 kilometers per hour in still water and so designed that when running at a speed, it will plane, i.e., its bow will rise from the water.

LESSON ROUND UP

- Sections 28 to 44D contain the provisions for computation of Income from Business and Profession.
- Section 28 defines the scope of income which can be taxed under this head.
- Sections 29 to 44D specify the method of computation of income under the business or profession.
- Expenses/allowances expressly allowed by the Act are listed under sections 29 to 37, whereas sections 40, 40A and 43B enumerate those expenses which are expressly disallowed while computing taxable income under this head.
- Section 44AA provides for maintenance of accounts by the assessee carrying on business or profession.
- Mandatory tax audit of accounts of the persons carrying on business or profession is prescribed in section 44AB.
- Computation of profit from business and profession on presumptive basis are covered under sections 44AD and 44AD.
- Section 44B laid down special provisions for computing profits and gains of shipping business in case of non-residents.
- Section 44D prescribed for special provisions for computing income by way of royalties etc, in case of foreign companies.

SELF TEST QUESTIONS

These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation.

MULTIPLE CHOICE QUESTIONS

1. Rate of depreciation chargeable on fully temporary wooden structure for the assessment year 2014-15 is –
 - (a) 5%
 - (b) 10%
 - (c) 100%
 - (d) None of the above.

2. Under the Income-tax Act, 1961, depreciation on machinery is charged on –

- (a) Purchase price of the machinery
- (b) Market price of the machinery
- (c) Written down value of the machinery
- (d) All of the above.

3. Depreciation allowance is charged @ _____ percent of written down value on intangible assets e.g. Know-how, patents, copyrights etc.

- (a) 15
- (b) 25
- (c) 20
- (d) 30

4. B contributed a sum of ₹ 30,000 to an approved institution for research in social science, which is not related to his business. The amount of deduction eligible under section 35 would be:

- (a) ₹ 30,000
- (b) ₹ 45,000
- (c) ₹ 37,500
- (d) No deduction as it is unrelated to his business

FILL IN THE BLANKS

1. Income of a business commenced on 1st March, 2014 will be assessed during the assessment year _____.

2. The amount of additional depreciation in respect of new building constructed in financial year 2013-14 at a cost of ₹ 25 lakh for manufacturing garments will be ₹ _____.

3. Deduction for bad debt is allowed to an assessee carrying on business in the year in which the debt is _____ as bad.

4. If an asset is put to use for less than 180 days in the previous year, the depreciation is charged at _____ of normal rate.

5. Under section 44AB, specified date means _____ of the assessment year.

SHORT NOTES

- 1. Methods of accounting
- 2. Scientific research expenditure

DISTINGUISH BETWEEN

- 1. Mercantile system of accounting and cash system of accounting.
- 2. Active user of asset and passive user of asset.
- 3. Normal depreciation and additional depreciation

ELABORATIVE

- 1. What is meant by 'block of assets'? Explain.
- 2. Discuss the items which are disallowed as deduction under section 40(b) while computing firm's income from business and profession.

3. What are the special provisions for computing profits and gains of retail business?

4. How will you compute income from Business or Profession?

5. Write notes on the following deductions:

- (i) Insurance Premium.
- (ii) Bonus.
- (iii) Interest on Borrowings.
- (iv) Contributions to Provident Fund, etc.
- (v) Animals.
- (vi) Bad Debts.

PRACTICAL QUESTIONS

1. From the following figures, you are required to ascertain the depreciation admissible in the Assessment year 2014-15:

Particulars	Machinery	Building
WDV as on 01-04-13	5,00,000	20,00,000
Additions during the year	6,00,000	Nil
Sale during the year	12,00,000	4,00,000
Rate of depreciation	15%	10%

2. Telefast Ltd. a company providing telecommunication services, obtain a telecom licence on 20-04-2013 for a period of 10 years which ends on 31-03-2023 (licence fee being ₹18 lakh). Find out the amount of deduction u/s 35ABB of the Income Tax Act, 1961, if:

- (a) the entire amount is paid on 06-05-2013;
- (b) the entire amount is paid on 01-04-2014;
- (c) the entire amount is paid in equal instalments on 30-04-2013; 30-04-2014; 30-04-2015.

ANSWERS/HINTS

Multiple choice question

1(c); 2(c); 3(b); 4(c)

Fill in the Blank

1. 2013-14; 2. Nil; 3. Written off; 4. 50%; 5. 30th September

Practical question

1. Nil, 1,60,000

2. Particular	Case (a)	Case (b)	Case (c)
Previous year 2013-14	1,80,000	NA	60,000
Previous year 2014-15	1,80,000	2,00,000	1,26,667
Previous year 2015-16 to 2022-23	1,80,000	2,00,000	2,01,667

Test Your Knowledge

1. (b)

2. False

3. False

SUGGESTED READINGS

1. Dr. V.K. Singhania : Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.

2. Girish Ahuja and Ravi Gupta : Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.

Lesson 4

Part IV – Income from Capital Gains

LESSON OUTLINE

- Capital Gains
- Capital Asset
- Transfer
- Distribution of assets by companies in liquidation (Section 46)
- Short-term and long-term capital gains
- Zero coupon bonds
- Computation of capital gain in certain cases
- Mode of computation and deductions
- Exemptions under section 54 to 54H
- Indexed Cost of Improvement
- Bonus shares and capital gains
- Computation of capital gains in respect of depreciable assets (Section 50)
- Cost of acquisition and capital gain in case of depreciable assets of electricity companies [Section 50A]
- Special provisions for computation of capital gains in case of slump sale [Section 50B]
- Computation of capital gain in real estate transaction [Section 50C]
- Reference to Valuation Officer (Section 55A)
- Lesson Round Up
- Self Test Question

LEARNING OBJECTIVES

The provisions for computation of Income from capital gains are covered under sections 45 to 55. Section 2(14) defines the term capital gain and section 45, the charging section lays down basis of change for taxability of capital gain/loss arises on transfer of capital asset.

Taxability of capital gain depends upon the nature of capital gain arises, i.e., short term capital gain or long term capital gain. The type of capital gain depends upon the period for which the capital asset is held. The taxability of capital gain shall satisfy the conditions like there should be capital asset, the asset is transferred by the assessee, such transfer takes place during the previous year, etc. To give relief to the assessee, the concept of exemption introduced under section 54, 54B, 54D, 54EC, 54F, 54G, 54GA, 54GB and 54H.

At the end of this lesson, you will learn

- the conditions to be satisfied for income to be chargeable under this head,
- which assets are classified as capital asset,
- the year in which the capital gains are chargeable to tax,
- classification of capital gain into long term and short term,
- which are the transactions not regarded as transfer,
- what are the exemptions available in respect of capital gains,
- when the assessing officer can make a reference to the valuation officer.

CAPITAL GAINS

Sections 45 to 55A of the Income-tax Act, 1961 deal with capital gains.

Section 45 of the Act, provides that any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in Sections 54, 54B, 54D, 54EC, 54ED, 54F, 54G, 54GA and 54H be chargeable to income-tax under the head "Capital Gains" and shall be deemed to be the income of the previous year in which the transfer took place.

Doubts may arise as to whether 'Capital Gains' being a capital receipt can be brought to tax as income. It may be noted that the ordinary accounting canons of distinctions between a capital receipt and a revenue receipt are not always followed under the Income-tax Act. Section 2(24)(vi) of the Income-tax Act specifically provides that "Income" includes "any capital gains chargeable under Section 45(1)". It may not be out of place to mention here that in the absence of a specific provision in Section 2(24) capital gains have no logic to be taxed as income. The constitutional validity of the provisions of the Act relating to capital gains was challenged in *Navin Chandra Mafatlal v. C.I.T.* (1955) 27 ITR 245. The Supreme Court while upholding the competence of parliament in legislating with regard to capital gains as part of income, observed that the term income should be given the widest connotation so as to include capital gains within its scope. However, all capital profits do not necessarily constitute capital gains. For instance, profits on re-issue of forfeited shares, profits on redemption of debentures, premium on issue of shares, 'pagri' from tenants etc. are capital profits and not capital gains, hence, not liable to tax.

The requisites of a charge to income-tax, of capital gains under Section 45(1) are:

- (i) *There must be a capital asset.*
- (ii) *The capital asset must have been transferred.*
- (iii) *The transfer must have been effected in the previous year.*
- (iv) *There must be a gain arising on such transfer of a capital asset. These requisites are briefly analyzed below.*
- (v) *Such capital gain should not be exempt under Sections 54, 54B, 54D, 54EC, 54ED, 54F, 54G, or 54GA*

CAPITAL ASSET

Unless the gain is relatable to a capital asset there can be no charge to capital gains tax. Section 2(14) of the Income-tax Act defines the term "capital asset" to mean:

Property of any kind held by an assessee whether or not connected with his business or profession but does not include:

- (i) **any stock-in-trade**, consumable stores or raw-materials held for the purposes of his business or profession;
- (ii) **personal effects** that is to say, movable property (including wearing apparel and furniture but excluding jewellery) held for personal use by the assessee or any member of his family dependent on him. Jewellery includes ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, whether or not containing any precious or semi-precious stone, and whether or not worked or sewn into any wearing apparel and precious or semi-precious stones, whether or not set in any furniture, utensil or other article or worked or sewn into any wearing apparel;
- (iii) **agricultural land in India**, not being land situate (a) within the jurisdiction of a municipality or a cantonment board and which has a population of not less than 10,000, or (b) in any area within the distance, measured aerially, –

- (I) not being more than two kilometres, from the local limits of any municipality or cantonment board referred to in item (a) and which has a population of more than ten thousand but not exceeding one lakh; or
- (II) not being more than six kilometres, from the local limits of any municipality or cantonment board referred to in item (a) and which has a population of more than one lakh but not exceeding ten lakh; or
- (III) not being more than eight kilometres, from the local limits of any municipality or cantonment board referred to in item (a) and which has a population of more than ten lakh.

Explanation.— For the purposes of this sub-clause, "population" means the population according to the last preceding census of which the relevant figures have been published before the first day of the previous year;

- (iv) **6½ per cent Gold Bonds**, 1977 or 7 per cent Gold Bonds, 1980 or National Defence Gold Bonds, 1980 issued by the Central Government;
- (v) **Special Bearer Bonds** 1991 issued by the Central Government.
- (vi) **Gold Deposit Bonds** issued under the Gold Deposit Scheme, 1999 notified by the Central Government.

The Supreme Court in the case of *Vodafone International Holdings B.V vs. Union of India* [2012] 204 Taxman 408 held that influence/persuasion of a parent company over its subsidiary could not be construed as a right in the legal sense.

To supersede this ruling with retrospective effect from 1st April 1962, an Explanation has been inserted to clarify that 'property' includes and shall be deemed to have always included any rights in or in relation to an Indian company, including rights of management or control or any other rights whatsoever.

The term property appearing in Section 2(14) has not been defined in the Income-tax Act. Even the Transfer of Property Act does not contain any definition of the term. But, the scope of Section 2(14) is very wide. With the exception of the aforementioned assets, all other assets are included in the category of capital asset. "Capital asset" includes movable/immovable asset, tangible/intangible assets, incorporeal rights and chose-in-action. It would also include share of a partner in a firm, goodwill of a firm, mining rights, industrial licence acquired by consideration, tenancy right or leasehold right, foreign currency, right to subscribe for shares, the contractual right of a purchaser to obtain title to an immovable property, etc. Some of the judicial rulings in this context are as follows:

Property is a term of widest importance and subject to any limitation which the context may require, it signifies every possible interest which a person can hold and enjoy [Ahmed G.H. Arif v. C.W.T. (1970) 76 ITR 471 (SC)].

Even business interest would be brought within the term property [C.I.T. v. Krishna Warrier (1964) 53 ITR 176 (SC)]. Even the business undertaking as a whole would fall within the definition of the term 'property' in Section 2(14) of the Act. [R.C. Cooperv. Union of India AIR 1970 (SC) 564]. The Gujarat High Court has rightly summed up as follows: The words "property of any kind", are words of widest amplitude. They exclude any limitation which may be sought to be introduced for the purpose of restricting the applicability of the definition. The adverbial clause "whether or not connected with his business or profession" also emphasizes the width and amplitude of the definition. Every kind of property held by an assessee, whatever be its nature or character, is within the connotation of the expression 'capital asset' provided, of course, it does not fall within the excepted categories specified in clauses (i) to (vi).

Cost of Self generated Capital Assets: The Madras High Court in *C.I.T. v. V.K. Rathnam Nadar* (1969) 71 ITR 433 held that capital gain arises only on the transfer of capital asset which had actually cost something to the assessee. Such actual cost in the context of the Income-tax Act being cost in terms of money, it cannot apply to transfer of capital asset which did not cost anything to the assessee in terms of money in its creation or acquisition. In other words, though self generated asset like goodwill is a capital asset in general law, its sale or transfer would not attract tax on capital gains in the hands of the person who has created it by carrying on his business

or profession, as the coming into existence or growth of self-created assets does not cost anything in terms of money. The Delhi, Calcutta, Kerala and Karnataka High Courts have taken the same view.

However, with effect from Assessment Year 1988-89, Section 55 is amended to remove this legal difficulty. It provides that where goodwill is self-generated, the cost of acquisition for computation of capital gain shall be deemed to be nil and where it has been purchased, the cost will be taken to be the actual price paid for it. The cost of improvement also in relation to goodwill be taken to be nil.

The Government has overcome the problem of taxing capital gains on transfer of three other categories of self-generated assets: with effect from the assessment year 1995-96, cost of tenancy rights, route permits and loomhours would also be deemed to be nil.

From Assessment year 2008-09, the scope of Section 2(14) has been expanded with the introduction of taxability provision with regards to "personal effects being archeological collections".

TRANSFER

The essential requirement for the incidence of tax on capital gains is the transfer of a 'capital asset'.

The Supreme court in the case of *Vodafone International Holdings B.V vs. Union of India* [2012] 204 Taxman 408 gave the following ruling –

- (a) the transfer of shares in the foreign holding company does not result in a extinguishment of the foreign company's control of the Indian company.
- (b) It does not constitute an extinguishment and transfer of an asset situated in India.
- (c) Transfer of foreign holding company shares offshore, cannot result in an extinguishment of the holding companies right of control of the Indian company and the same does not constitute extinguishment and transfer of an asset/management and control of property situated in India.

To supersede this ruling with retrospective effect from 1st April 1962, Explanation 2 to section 2(47) has been inserted which defines transfer as follows:

'Transfer' includes and shall be deemed to have always included disposing of or parting with an asset or any interest therein, or creating any interest in any asset in any manner whatsoever, directly or indirectly, absolutely or conditionally, voluntarily or involuntarily by way of an agreement (whether entered into in India or outside India) or otherwise, notwithstanding that such transfer of rights has been characterized as being effected or dependent upon or flowing from the transfer of a share or shares of a company registered or incorporated outside India.

The above transactions would be deemed as a transfer notwithstanding that such transfer of rights has been characterized as being effected or dependent upon or flowing from the transfer of a share or shares of a company registered or incorporated outside India.

The distribution of capital assets on the dissolution of a firm, body of individuals or other association of persons, is also regarded as transfer liable to capital gains tax. For the purposes of computing capital gain in such cases, the fair-market value of the capital asset on the date of such distribution will be deemed to be the full value of consideration received or accruing as a result of transfer of the capital asset.

Transactions which do not constitute transfer [Sections 46 and 47]

- (i) any distribution of capital assets on the total or partial partition of a Hindu Undivided Family;
- (ii) any transfer of a capital asset under a gift or will or an irrevocable trust;

Provided that this clause shall not apply to transfer under a gift or an irrevocable trust of a capital asset being shares, debentures or warrants allotted by a company directly or indirectly to its employees under the Employees' Stock Option Plan or Scheme of the company offered to such employees in accordance with the guidelines issued by the Central Government in this behalf;

- (iii) any transfer of a capital asset by a company to its subsidiary company, if–
 - (a) the parent company or its nominees hold the whole of the share capital of the subsidiary company, and
 - (b) the subsidiary company is an Indian company;
- (iv) any transfer of a capital asset by a subsidiary company to the holding company, if –
 - (a) the whole of the share capital of the subsidiary company is held by the holding company, and
 - (b) the holding company is an Indian company;
- (v) any transfer, in a scheme of amalgamation, of a capital asset by the amalgamating company to the amalgamated company if the amalgamated company is an Indian company;
- (vi) any transfer in a scheme of amalgamation of a capital asset being share or shares held in an Indian Company, by the amalgamating foreign company to the amalgamated foreign company, if –
 - (a) at least twenty-five per cent of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company; and
 - (b) such transfer does not attract tax on capital gains in the country, in which the amalgamating company is incorporated (applicable from the assessment year 1993-94);
- (viaa) any transfer in a scheme of amalgamation of a banking company with a banking institution sanctioned and brought into force by the Central Government under Sub-section (7) of Section 45 of the Banking Regulation Act, 1949, of a capital asset by the banking company to the banking institution.
- (vib) any transfer, in a demerger, of a capital asset by the demerged company to the resulting company, if the resulting company is an Indian company.
- (vic) any transfer in a demerger, of a capital asset, being a share or shares held in an Indian company, by the demerged foreign company to the resulting foreign company, if –
 - (a) the shareholders holding not less than three-fourths in value of the shares of the demerged foreign company continue to remain shareholders of the resulting foreign company; and
 - (b) such transfer does not attract tax on capital gains in the country in which the demerged foreign company is incorporated provided that the provisions of Sections 391 to 394 of the Companies Act, 1956 (1 of 1956) shall not apply in case of demerger referred to in this clause.
- (vid) any transfer or issue of shares by the resulting company in a scheme of demerger to the shareholders of the demerged company if the transfer or issue is made in consideration of demerger of the undertaking.
- (vii) any transfer by a shareholder, in a scheme of amalgamation, of a capital asset being a share or shares held by him in the amalgamating company, if –
 - (a) the transfer is made in consideration of the allotment to him of any share or shares in the amalgamated company except where the shareholder itself is the amalgamated company, and
 - (b) the amalgamated company is an Indian company;
- (vvia) any transfer of a capital asset of such foreign currency convertible bonds or Global Depository Receipts as are referred to in Section 115AC(1) held by a non-resident to another non-resident where the transfer is made outside India (applicable from 1.6.1992);
- (viii) any transfer of agricultural land in India effected before the first day of March, 1970;
- (ix) any transfer of a capital asset being any work of art, archaeological, scientific or art collection, book, manuscript, drawing, painting, photograph or print to the Government or a University or the National Museum, National Art Gallery, National Archives or any such other public museum or institution as may be notified by the Central Government in the Official Gazette to be of national importance or to be of renown throughout any State or States;

- (x) any transfer by way of conversion of bonds or debentures, debenture stock or deposit certificates in any form, of a company, into shares or debentures of that company.
- (xi) any transfer made on or before 31.12.1998 by a person not being a company of a capital asset being membership of a recognised stock exchange to a company in exchange for shares allotted by that company to him (transferor).
- (xii) any transfer of land by a sick industrial company made at any time beginning with declaration of it being sick by the BIFR and ending with the previous year in which its net worth wipes out the accumulated losses.
- (xiii) where a firm is succeeded by a company in the business carried on by it as a result of which the firm sells or otherwise transfers any capital asset or intangible asset to the company:

Any transfer of a capital asset or intangible asset by a firm to a company as a result of succession of the firm by a company in the business carried on by the firm, or any transfer of a capital asset to a company in the course of the demutualisation or corporatisation of a recognised stock exchange in India as a result of which an association of persons or body of individuals is succeeded by such company.

Provided that —

- (a) all the assets and liabilities of the firm or of the association of persons or body of individuals relating to the business immediately before the succession become the assets and liabilities of the company,
 - (b) all the partners of the firm immediately before the succession become the shareholders of the company in the same proportion in which their capital account stood in the books of the firm on the date of succession.
 - (c) the partners of the firm do not receive any consideration or benefit, directly or indirectly in any form or manner, other than by way of allotment of shares in the company, and
 - (d) the aggregate of the share holding in the company of the partners of the firm is not less than fifty per cent of the total voting power in the company and their shareholding continue to be as such for a period of five years from the date of succession.
 - (e) the demutualisation or corporatisation of a recognised stock exchange in India is carried out in accordance with a scheme for corporatisation which is approved by the Securities and Exchange Board of India established under Section 3 of the Securities and Exchange Board of India Act, 1992.
 - (xiiia) any transfer of a capital asset being a membership right held by a member of a recognised stock exchange in India for acquisition of shares and trading or clearing rights acquired by such member in that recognised stock exchange in accordance with a scheme for demutualisation or corporatisation which is approved by the Securities and Exchange Board of India established under Section 3 of the Securities and Exchange Board of India Act, 1992 (15 of 1992).
 - (xiiib) any transfer of a capital asset or intangible asset by a private company or unlisted public company (hereafter in this clause referred to as the company) to a limited liability partnership or any transfer of a share or shares held in the company by a shareholder as a result of conversion of the company into a limited liability partnership
- Conditions for claiming exemption**
- (a) all the assets and liabilities of the company immediately before the conversion become the assets and liabilities of the limited liability partnership
 - (b) all the shareholders of the company immediately before the conversion become the partners of the limited liability partnership and their capital contribution and profit sharing ratio in the limited

liability partnership are in the same proportion as their shareholding in the company on the date of conversion

- (c) the shareholders of the company do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of share in profit and capital contribution in the limited liability partnership
 - (d) the aggregate of the profit sharing ratio of the shareholders of the company in the limited liability partnership shall not be less than fifty per cent at any time during the period of five years from the date of conversion
 - (e) the total sales, turnover or gross receipts in business of the company in any of the three previous years preceding the previous year in which the conversion takes place does not exceed sixty lakh rupees and
 - (f) no amount is paid, either directly or indirectly, to any partner out of balance of accumulated profit standing in the accounts of the company on the date of conversion for a period of three years from the date of conversion.
- (xiv) where a sole proprietary concern is succeeded by a company in the business carried on by it as a result of which the sole proprietary concern sells or otherwise transfers any capital asset or intangible asset to the company.

Provided that –

- (a) all the assets and liabilities of the sole proprietary concern relating to the business immediately before the succession becomes the assets and liabilities of the company;
 - (b) the shareholding of the sole proprietor in the company is not less than fifty per cent of the total voting power in the company and his shareholding continues to so remain as such for a period of five years from the date of the succession; and
 - (c) the sole proprietor does not receive any consideration or benefit directly or indirectly in any form or manner, other than by way of allotment of shares in the company.
- (xv) any transfer in a scheme for lending of any securities under an agreement or arrangement, which the assessee has entered into with the borrower. Of such securities and which is subject to the guidelines issued by the Securities and Exchange Board of India, established under Section 3 of the Securities and Exchange Board of India Act, 1992 or the Reserve Bank of India in this regard.
- (xvi) any transfer of a capital asset in a transaction of reverse mortgage under a scheme made and notified by the Central Government.

Thus, transfer of capital assets falling in any of the categories discussed above would not attract liability to capital gains tax. The following points should be noted:

The fact that a transfer becomes void under Section 281 of the Act does not in any way preclude levy of capital gains tax. In the case of transfer of shares held as capital asset, the date of transfer is the date of delivery of the share certificates to the transferee and not the date of registration of the shares in the name of the transferee in the register of company. This apart, it is essential that on the date of transfer the asset should have been held as capital asset in order to attract Section 45 of the Act. Further the notional profit arising from transfer by way of conversion of capital asset into stock-in-trade will be chargeable to tax in the year in which stock-in-trade is sold. For the purpose of computing the capital gain in such cases, the fair market value of the capital asset on the date on which it was converted or treated as stock-in-trade will be deemed to be the full value of consideration receiving or accruing as a result of the transfer of the capital asset.

The following case laws, on the concept of transfer may also be taken note of:

Where the Tribunal held that having regard to the scheme of amalgamation between the assessee and another company, no sum could be assessed in the hands of the assessee as no capital gains had accrued to it by exchange or relinquishment as provided in Section 12B of the 1922 Act, it was held that in view of the decision in *CIT v. Rasiklal Maneklal (HUF)* [1974] 95 ITR 656 (Bom.) the order of the Tribunal was to be upheld - *CIT v. Mafatlal Gagalbhai & Co. (P.) Ltd.* [1989] 42 Taxman 26/177 ITR 488 (Bom.).

Where the assessee, who is shareholder of company A and company A was amalgamated with another company B and the assessee received shares of the company B in lieu of the shares of A, neither an 'exchange' nor a 'relinquishment' takes place and hence no capital gains will be leviable. *CIT v. Rasiklal Maneklal (HUF)* [1989] 43 Taxman 259/177 ITR 198 (SC).

Handing over of capital asset to firm amounts to a transfer, but no capital gains liable to income-tax accrue to assessee thereby – *Ved Parkash Aggarwal v. CIT* (1989) 46 Taxman 31/179 ITR 378 (Punj. and Har.).

Making over of immovable properties by assessee-firm to partners at their book value by making necessary book entries would not amount to transfer of capital asset within the meaning of Section 2(47) and, therefore, would not attract capital gains tax – *CIT v. Bharati Engg. Corp.* [1989] 46 Taxman 80/180 ITR 32 (Punj. & Har.). A new Sub-section (1A) has been inserted in Section 45 by the Finance Act, 1999 w.e.f. 1.4.2000. It provides that where any person receives any money or other assets under an insurance from the insurer on account of damage to or destruction of any capital asset, as a result of flood, typhoon, hurricane, cyclone, earth quake or other convulsion of nature or on account of riot or civil disturbance or accidental fire or explosion or because of action by an enemy or action taken in combating an enemy (whether with or without a declaration of war), then any profits or gains arising from receipt of such money or other asset shall be chargeable to income tax under the head 'capital gains' and shall be deemed to be the income of such person of the previous year in which such money or other asset was received.

The money so received or/and fair market value of the other asset received shall constitute the full value of consideration for the purposes of computation of capital gains.

Revaluation of Asset will not amount to 'transfer' and hence will not result into any liability under the Income Tax Act. [*Well Pack Packaging v. CIT* (2003) 130 Taxamnn 215 (Mag.)].

Withdrawal of exemption in certain cases (Section 47A)

Section 47A provides that if, at any time, before the expiry of eight years from the date of transfer of a capital asset by a company to its wholly owned subsidiary company as provided in clauses (iv) or (v) of Section 47, or by the subsidiary company to the holding company respectively, such capital asset is converted by the transferee company into or is treated by it as, stock-in-trade of its business, or the parent company (or its nominee) or the holding company ceases to hold the whole of the share capital of the subsidiary company before the expiry of the period of eight years aforesaid, the amount of capital gains exempted from tax by virtue of the provisions contained in Section 47 will be deemed to be income of the transferor company chargeable under the head "capital gains" of the year in which such transfer took place.

In terms of Section 47A(2) where a person gets exemption from capital gains tax on transfer of his membership in a recognised stock exchange during the course of corporatisation of his business in terms of Section 47(xi) and he within three years from the date of such transfer sells any of the shares allotted in lieu thereof by the company, the capital gains exempted vide Section 47(xi) will become the capital gains of the previous year in which the shares are transferred.

In terms of Section 47A(3) inserted by Finance (No. 2) Act, 1998, if the conditions stipulated regarding the succession of proprietary concern or firm by the company whereby capital gain is not levied, are not complied with the benefits availed by the sole proprietor or the firm, as the case may be, shall be deemed to be profit and gains of the successor company chargeable to tax in the year in which infringement takes place.

As per section 47A(4) where any of the conditions laid down in the proviso to clause (xiib) of section 47 are not complied with, the amount of profits or gains arising from the transfer of such capital asset or intangible asset or share or shares not charged under section 45 by virtue of conditions laid down in the said proviso shall be deemed to be the profits and gains chargeable to tax of the successor limited liability partnership or the shareholder of the predecessor company, as the case may be, for the previous year in which the requirements of the said proviso are not complied with.

DISTRIBUTION OF ASSETS BY COMPANIES IN LIQUIDATION (SECTION 46)

Section 46(1) provides that notwithstanding anything contained in Section 45, where the assets of a company are distributed to its shareholders on its liquidation, such distribution shall not be regarded as a transfer by the company for the purposes of Section 45. This sub-section applies only to the distribution of capital assets in specie by a company in liquidation among its shareholders. Capital gains made by the liquidator of a company on sale of the company's assets with the object of distributing the sale proceeds among shareholders, are assessable in the hands of the company [*Kannan Rice Mills Ltd. v. C.I.T. (1954) 26 ITR 351*]. Further analysis of this sub-section would reveal that if the distribution is otherwise than on liquidation of the company, this section cannot be attracted. Moreover, the distribution of assets should have been made to the shareholders of the company. "Shareholders" would mean registered shareholders only and not the beneficial owners of shares [*Howrah Trading Co. Ltd. v. C.I.T. (1959) 36 ITR 215 (S.C.)*].

Sub-section (2) of Section 46 provides that where a shareholder, on the liquidation of a company, receives any money or other assets from the company, he shall be chargeable to income-tax under the head "capital gains" in respect of the money so received or the market value of the other assets on the date of distribution, as reduced by the amount assessed as dividend within the meaning of sub-clause (c) of clause (22) of Section 2 and the sum so arrived at shall be deemed to be the full value of the consideration for the purpose of Section 48. But for this sub-section, any cash or other assets received by a shareholder on liquidation of the company would not be assessable to tax as capital gains. [*C.I.T. v. Chimanlal B. Parikh (1973) 92 ITR 59*].

It is once again emphasised that but for the enlarged scope of the definition of the term 'transfer' in Section 2(47) and Section 46(2) of the Income-tax Act, 1961, the money received by a shareholder from the company on liquidation would not be brought to tax, as the money received by him represents only satisfaction of the right which belonged to him by virtue of his holding the shares and not by operation of any transaction which amounts to the sale, exchange, relinquishment or other transfer of his shares [*C.I.T. v. Madurai Mills Company Ltd. (1973) 89 ITR 45 (S.C.)*]. Thus, the distributed assets and/or moneys which are, as a matter of fact not a consideration for 'transfer' are deemed, under Section 46(2), to be capital gains chargeable to tax.

SHORT-TERM AND LONG-TERM CAPITAL GAINS

Any capital gain arising as a result of transfer of a short-term capital asset is known as short-term capital gain. According to Section 2(42A) of the Income-tax Act:

"Short term" capital asset means a capital asset held by an assessee for not more than thirty-six months immediately preceding the date of its transfer. In the case of capital assets (being equity or preference share in a company) held by an assessee for not more than 12 months immediately prior to its transfer.

In determining the period for which a capital asset is held by an assessee, the following must be noted:

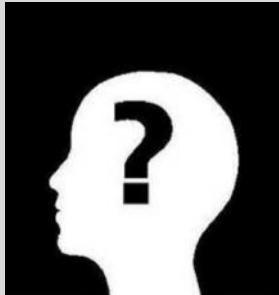
- (i) In the case of shares held in a company in liquidation, the period subsequent to the date on which the company goes into liquidation shall be excluded.
- (ii) In case the asset becomes the property of the assessee under the circumstances mentioned in Section 49(1) – discussed later in this lesson - the period for which the asset was held by the previous owner shall be included.

- (iii) In the case of the shares in an Indian Company which become the property of the assessee in a scheme of amalgamation, the period for which the shares in the amalgamating company were held by the assessee shall be included.
- (iv) In the case of a capital asset, being a share or any other security subscribed to by the assessee on the basis of his right to subscribe to such financial asset or subscribed to by the person in whose favour the assessee has renounced his right to subscribe to such financial asset, the period shall be reckoned from the date of allotment of such financial asset;
- (v) In the case of a capital assets, being the right to subscribe to any financial asset, which is renounced in favour of any other person, the period shall be reckoned from the date of the offer of such right by the company or institution, as the case may be, making such offer.
- (vi) In the case of a capital asset, being a financial asset, allotted without any payment and on the basis of holding of any other financial asset, the period shall be reckoned from the date of the allotment of such financial asset.
- (vii) In the case of a capital asset, being a share or shares in an Indian company, which becomes the property of the assessee in consideration of a demerger, there shall be included the period for which the share or shares held in the demerged company were held by the assessee.
- (viii) In the case of a capital asset, being trading or clearing rights of a recognized stock exchange in India acquired by a person pursuant to demutualisation or corporatisation of the recognized stock exchange in India as referred to in Clause (xiii) of Section 47, there shall be included the period for which the person was a member of the recognized stock exchange in India immediately prior to such demutualisation or corporatisation;
- (viiiia) In the case of a capital asset, being equity share or shares in a company allotted pursuant to demutualisation or corporatisation of a recognised stock exchange in India as referred to in Clause (xiii) of Section 47, there shall be included the period for which the person was a member of the recognized stock exchange in India immediately prior to such demutualisation or corporatisation;

Long Term Capital Asset

Assets other than short-term capital assets are known as '**long-term capital assets**' and the gains arising therefrom are known as 'long-term capital gains'. Note that with effect from assessment year 1988-89, a share, equity or preference held by an assessee would be regarded as a long-term capital asset if the ownership is for more than 12 months with him. In the case of other long- term capital assets, the period of holding is determinable subject to any rules made by CBDT.

Test Your Knowledge



1. Short-term capital asset means a capital asset held by an assessee for not more than _____ immediately preceding the date of its transfer.
 - (a) 15 months
 - (b) 20 months
 - (c) 36 months
 - (d) 12 months

Zero Coupon Bonds

The Finance Act, 2005 has introduced the procedure regarding the taxation of the income on the Zero Coupon Bonds being issued on or after 1.6.2005. "Zero Coupon Bond" as defined under Section 2(48) means a bond –

- (a) issued by any infrastructure capital company or infrastructure capital fund or public sector company on or after the 1st day of June, 2005;
- (b) in respect of which no payment or benefit is received or receivable before maturity or redemption from infrastructure capital company or infrastructure capital fund or public sector company; and
- (c) which the Central Government may, by notification in the Official Gazette, specify in this behalf.

For the purpose of this clause, the expressions "infrastructure capital company" and "infrastructure capital fund" shall have the same meanings respectively assigned to them under clauses (a) and (b) of Explanation 1 to clause (23G) of Section 10.

As per Clause (b) above, the payment of and benefit from zero coupon bond shall be received or receivable from the issuing company/fund only at the time of maturity or redemption. Consequently, Clause (via) has been inserted in

Section 2(47) to provide that the maturity or redemption of a zero coupon bond shall be regarded as a transfer.

The profits arising on the transfer of such zero coupon bond shall be chargeable under the head "capital gains". Further, Section 2(42A) has been amended to provide that if such zero coupon bonds are held for not more than 12 months, such capital asset shall be treated as short-term capital asset and hence shall be subject to short-term capital gain. On the other hand, where these bonds are held for more than 12 months, such capital gain shall be treated as long-term capital gain.

The proviso under Section 112(1) has been amended to include zero coupon bonds. Therefore, where the tax payable in respect of any income arising from the transfer of a long-term capital asset being zero coupon bonds exceeds 10% of the amount of capital gain, before giving effect to the provisions of the second proviso to Section 48 (i.e. before giving effect to indexed cost) such excess shall be ignored for the purpose of computing the tax payable by the assessee.

In other words, long term capital gain on zero coupon bonds shall be chargeable to tax at minimum of the following two :

- (a) 20% of long term capital gain after indexation of cost of such bonds, or
- (b) 10% of long term capital gain before indexation of cost of such bonds.

MODE OF COMPUTATION AND DEDUCTIONS

Section 48 of the Act provides that the income chargeable under the head 'capital gains' shall be computed by deducting from the full value of consideration received or accruing as a result of the transfer of the capital asset the following amounts, namely (as applicable from the assessment year 1993-94) -

- (i) the expenditure incurred wholly and exclusively in connection with such transfer;
- (ii) the cost of acquisition of the capital asset and the cost of any improvement thereto.

However, in the case of an assessee who is a non-resident, capital gains arising from the transfer of a capital asset, being shares in, or debentures of, an Indian company shall be computed by converting the cost of acquisition, expenditure incurred wholly and exclusively in connection with such transfer and the full value of the consideration received or accruing as a result of the transfer of the capital asset into the same foreign currency

as was initially utilised in the purchase of the shares or debentures, and the capital gains so computed in such foreign currency shall be reconverted into Indian currency.

Further, the above manner of computation of capital gains shall be applicable in respect of capital gains accruing or arising from every re-investment thereafter in, and sale of, shares in, or debentures of, an Indian Company.

Where long term capital gain arises from the transfer of a long term capital asset (other than capital gain arising to a non-resident from the transfer of shares in or debentures of an Indian company), such long term capital gains will be computed by deducting from the full value of consideration, the expenditure incurred in connection with the transfer, the 'indexed cost of acquisition' and 'indexed cost of improvement'.

The Finance Act, 1997 has with effect from 1.4.1998 denied the benefit of indexation of cost of bonds and debentures other than indexed bonds issued by the government.

Provided also that where shares, debentures or warrants referred to in the proviso to Clause (iii) of Section 47 are transferred under a gift or an irrevocable trust, the market value on the date of such transfer shall be deemed to be the full value of consideration received or accruing as a result of transfer for the purposes of this section.

For this purpose:

- (i) "**foreign currency**" and "**Indian currency**" have the meanings respectively assigned thereto in Section 2 of the Foreign Exchange Management Act, 1999, and
- (ii) the **conversion of Indian currency into foreign currency** and the re-conversion of foreign currency into Indian currency shall be at the rate of exchange prescribed in that behalf;
- (iii) '**indexed cost of acquisition**' means an amount which bears to the cost of acquisition the same proportion as Cost Inflation Index for the year in which the asset is transferred bears to the Cost Inflation Index for the first year in which the asset was held by the assessee or for the year beginning on the 1st day of April 1981 whichever is later;
- (iv) '**indexed cost of any improvement**' means an amount which bears to the cost of improvement the same proportion as Cost Inflation Index for the year in which the asset is transferred bears to the Cost Inflation Index for the year in which the improvement to the asset took place; and
- (v) '**cost inflation index**', in relation to a previous year, means such Index as the Central Government may, having regard to seventy-five per cent of average rise in the Consumer Price Index for urban non-manual employees for the immediately preceding previous year to such previous year, by notification in the Official Gazette, specify in this behalf.

Commission paid to a broker for effecting sale of the asset falls under (i) above. Similarly expenditure incurred on litigation for getting enhanced compensation is expenditure wholly and exclusively incurred in connection with transfer of the capital asset and is deductible. [*V.A. Vasumathi v. C.I.T.* (1980)123 ITR 94 (Ker.)]. However, litigation expenses incurred for having the shares registered in his name are part of the cost of acquisition and that incurred for gaining better voting rights is cost of improvement [*C.I.T. v. Bengal Assam Investors Ltd.* (1969) 72 ITR 319 (Cal.)] (Cost of improvement and cost of acquisition are elaborately explained under para 9). Section 48 of the Act does not an Assessing Officer from taking into account sale consideration stated in the deed or actual consideration received by the assessee whichever is higher. [*Interpal Singh Ahuja v. CIT* (2006) 103 ITD/100 TTJ 497 (Asr.)].

Formula for computation of –

Indexed Cost of Acquisition and

Indexed Cost of Improvement.

Indexed Cost of Acquisition

Cost of acquisition shall have to be adjusted by the Cost Inflation Index to arrive at the indexed cost of acquisition, as follows:

For assets acquired before 1.4.1981 by the assessee

Indexed Cost of Acquisition =	Cost of Acquisition or Fair Market Value of the asset as on 1.4.1981 <u>whichever is higher</u>	Cost Inflation Index for the financial year in which the asset is transferred (Cost Inflation Index for 1981-82)
Indexed Cost of Acquisition	= $\frac{\text{Cost of improvement} \times \text{Cost Inflation Index}}{\text{Cost Inflation Index for 1981-82}}$	

Also add cost of improvement before 1.4.81.

For assets acquired by the assessee on or after 1.4.1981

Indexed Cost of Acquisition =	Cost of Acquisition x	Cost Inflation index for the year in which the asset is transferred Cost Inflation Index for the first year in which the asset is acquired by the assessee
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Indexed Cost of Improvement

$= \frac{\text{Cost of Improvement} \times \text{Cost Inflation index for the year in which the asset is transferred}}{\text{Cost Inflation Index for the year in which improvement to the asset took place.}}$

Cost Inflation Index specified for purpose of computation of capital gains

In exercise of the powers conferred by clause (v) of the Explanation to Section 48 of the Income-tax Act, 1961 (43 of 1961), the Central Government, having regard to seventy-five per cent of the average rise in the Consumer Price Index for urban non-manual employees, has specified the Cost Inflation Index as mentioned in column (3) of the Table below for the financial year mentioned in the corresponding entry in column (2) of the said Table.

TABLE

Sl. No.	Financial year	Cost Inflation Index
(1)	(2)	(3)
1.	1981-82	100
2.	1982-83	109
3.	1983-84	116
4.	1984-85	125
5.	1985-86	133
6.	1986-87	140
7.	1987-88	150

8.	1988-89	161
9.	1989-90	172
10.	1990-91	182
11.	1991-92	199
12.	1992-93	223
13.	1993-94	244
14.	1994-95	259
15.	1995-96	281
16.	1996-97	305
17.	1997-98	331
18.	1998-99	351
19.	1999-00	389
20.	2000-01	406
21.	2001-02	426
22.	2002-03	447
23.	2003-04	463
24.	2004-05	480
25.	2005-06	497
26.	2006-07	519
27.	2007-08	551
28.	2008-09	582
29.	2009-10	632
30.	2010-11	711
31.	2011-12	785
32.	2012-13	852
33.	2013-14	939

Illustration:

On 15th November, 2013 Mohan sold 1 kg. of gold, the sale consideration of which was ₹ 4,50,000. He acquired the gold on August 18, 1978 for ₹ 64,000. Fair market value of 1 kg. of gold on April 1, 1981 was ₹ 62,000.

Find out the amount of capital gain chargeable to tax for the assessment year 2014-15 using the cost inflation index table as given.

Computation of capital gains:

	₹
Sale proceeds of gold	4,50,000
Less: Indexed Cost of Acquisition	<u>5,82,180</u>
Long-term Capital loss	<u>1,32,180</u>

Determination of Indexed Cost of Acquisition

In this case since the asset was purchased before 1.4.1981 and fair market value of gold as on 1.4.1981 is more than the cost of acquisition of gold, it is beneficial for the assessee to opt for Fair Market Value of gold as on 1.4.1981 for computation of capital gains.

₹	
Fair Market Value of Gold on 1.4.1981	62,000
Cost inflation index - for the year 1981-82	100
Indexed cost of acquisition $\left(62,000 \times \frac{939}{100} \right) = 5,82,180$	

Tax on Long-term Capital Gains (Section 112)

Section 112 has been inserted with effect from April 1, 1993 for computation of Income-tax on Long-term Capital gains. Long-term Capital gains will be taxable at a flat rate 20%.

Finance Act, 1999 with effect from assessment year 2000-01 has provided that -

In respect of listed securities or units or zero tax coupon bonds, assessee have the option of :

- *paying tax @ 20% on long-term capital gain computed by considering the 'indexed' cost of acquisition and improvement; or*
- *paying tax @ 10% on long-term capital gains computed by considering the actual i.e. the historical cost.*

This option can be exercised separately in respect of each transaction i.e. exercise of the first option in respect of one transaction does not preclude the assessee from exercising the second option in respect of a subsequent transaction(s) during the same previous year.

Assessee must exercise this choice judiciously on a comparison of tax liability under the two options. In respect of long-term capital gains from transfer of bonus shares, invariably the second option will be exercised.

The assets covered under this provision are securities defined under Section 2(h) of the Securities Contracts (Regulation) Act, 1956 listed on any recognised stock exchange in India.

As per Section 2(h) "Securities includes shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature of any company, Government Securities and other notified instruments.

In respect of such long-term capital gain, deductions under Chapter VIA (i.e. under Sections 80C to 80U) are not allowed. Further, income other than long term capital gains will be subject to tax at the rates in force.

Costs with reference to certain modes of acquisition

Capital gains are ascertained after taking into consideration the cost of acquisition of the capital asset by the assessee. The cost of acquisition is easily determinable where the asset has been purchased by the assessee. In some cases the assessee would have acquired the asset not necessarily by purchase but by the following modes namely:

(A) Cost to the previous owner

- (i) on the distribution of assets on the total or partial partition of a Hindu Undivided Family;
- (ii) under a gift or will;
- (iii) (a) by succession, inheritance or devolution; or
- (b) on any distribution of assets on the dissolution of a firm, body of individuals or other association of persons where such dissolution has taken place at any time before 1.4.1987; or

- (c) on any distribution of assets on the liquidation of a company; or
 - (d) under a transfer to a revocable or irrevocable trust; or
 - (e) under any such transfer as is referred to in clause (iv) or clause (v) or clause (vi) or clause (via) of Section 47 - see para 3 already discussed.
- (iv) by the mode referred to in Sub-section (2) of Section 64 at any time after 31.12.1969, by an assessee, being a Hindu Undivided Family.

In all the above cases, Section 49(1) states that the cost of acquisition of the assets shall be deemed to be the cost for which the previous owner of the property acquired it, as increased by the cost of any improvement of the assets, incurred or borne by the previous owner or the assessee as the case may be. 'Previous owner of the property' means the last previous owner of the capital asset who acquired it by a mode other than that referred to in (i) to (iv) above. An example would make this point clear. X had built a house at a cost of ₹ 50,000. X gifted the house to Y, Y to Z and Z to A. The cost of acquisition of the house for A for the purpose of ascertaining any capital gain arising on the sale of the house by A would be ₹ 50,000. In other words, since the previous owner, namely, Z, acquired it free of cost, i.e., by gift, it cannot be said that cost of acquisition of the house for A is nil.

Section 55(3) of the Act provides that where the cost for which the previous owner acquired the property cannot be ascertained, the cost of acquisition to the previous owner means the fair market value on the date on which the capital asset became the property of the previous owner.

(B) Cost of shares in the amalgamated company

Sub-section (2) of Section 49 provides that where the capital asset being a share or shares in an amalgamated company which is an Indian company became the property of the assessee in consideration of a transfer referred to in clause (vii) of Section 47, the cost of acquisition of the asset shall be deemed to be the cost of acquisition to him of the share or shares in the amalgamating company.

(C) Cost of acquisition in cases of conversion of debenture/debenture stock/deposit certificate into shares

Sub-section 2A, as inserted retrospectively from 1.4.1962 by Finance (No. 2) Act, 1991 states that where the capital asset being a share or debenture in a company became the property of the assessee in consideration of a transfer referred to in Section 47(x), the cost of acquisition of the asset to the assessee shall be deemed to be that part of the cost of debenture, debenture stock or deposit certificates in relation to which such asset is acquired by the assessee.

(D) Where the capital gain arises from the transfer of **specified security or sweat equity shares** referred to in sub-clause (vi) of clause (2) of section 17, the cost of acquisition of such security or shares shall be the fair market value which has been taken into account for the purposes of the said sub-clause. [Section 49(2AA)]

(E) Further, Sub-section (3) of Section 49 provides that where the capital gain arising from the transfer of a capital asset referred to in Section 47(iv) or (v) is deemed, by virtue of the provisions in Section 47A, to be income chargeable under the head 'capital gains', the cost of acquisition of such asset to the transferee company will be the cost for which such asset was acquired by it.

Meaning of cost of acquisition [Section 55(2)]

For the purposes of Sections 48 and 49, 'cost of acquisition' of goodwill of a business or a right to manufacture, produce or process any article or thing, tenancy rights, stage carriage permits or loom hours is:

- (i) in the case of acquisition of such asset by the assessee by purchase from a previous owner, cost of acquisition means the amount of the purchase price; and
- (ii) in any other case cost of acquisition shall be Nil.

Cost of an asset acquired before 1.4.1981:

- (i) where the capital asset became the property of the assessee before 1.4.1981, cost of acquisition means the cost of acquisition of the asset to the assessee or the fair market value of the asset as on 1.4.1981 at the option of the assessee and the indexation of cost will be available with reference to such actual cost of acquisition or the FMV as opted for by the assessee;
- (ii) where the capital asset became the property of the assessee by any of the modes specified in Section 49(1) and the capital asset became the property of the previous owner before 1.4.1981 cost of acquisition means the cost of capital asset to the previous owner or the fair market value of the asset as on 1.4.1981 at the option of the assessee. However the indexation will commence from the year in which the asset became the property of the assessee and not 1981-82.

If a depreciable capital asset becomes the property of assessee under the circumstances mentioned in para 9, he has got an option to substitute the fair market value of the asset on April 1, 1981 in place of its cost of acquisition. If, however, an assessee acquires a depreciable asset in the circumstances, other than those mentioned in para 9, he cannot opt for fair market value on April 1, 1981 in the place of its cost of acquisition [Section 50(2) - *Rajnagar Vaktapur Ginning, Pressing & Mfg. Co. Ltd. v. CIT* (1975) 99 ITR 264 (Guj.) and *India Jute Co. Ltd. v. CIT* (1981) 6 Taxman 239 (Cal.)].

Unearned increase in value of land is not to be deducted while determining FMV (Fair Market Value) of property as on April 1, 1981. [*CIT v. Rekha Mathur* (2006) 152 Taxman 70 (Mag.) (Del.)].

The option given to the assessee to substitute the fair market value of the asset on 1.4.1981 is to ensure that capital gains are not computed with reference to some historical cost; and thus mitigate the hardship to some of the assessees who would have acquired the asset at cheaper cost, fifteen or even twenty years back. Keeping in view this, the Finance Act, 1992 has introduced the system of indexation which has already been discussed elsewhere in this chapter.

Cost of assets acquired on liquidation of a company

- (iii) where the capital asset became the property of the assessee on the distribution of capital assets of a company on its liquidation and the assessee has been assessed to income-tax under the head 'capital gains' in respect of that asset under Section 46, 'cost of acquisition' means the market value of the asset on the date of distribution.

Cost of Securities

Cost of original shares, acquired directly from a company or otherwise, shall be deemed to be the actual price paid therefor just as the cost of rights shares shall be deemed to be the actual price paid therefor to the company plus any amount to the renouncer. Cost of bonus shares shall be deemed to be Nil. Cost of renunciation of rights shall also be deemed to be Nil.

Cost on consolidation or conversion of shares

- (iv) where the capital asset, being a share or a stock of a company, became the property of the assessee on –
 - (a) the consolidation and division of all or any of the share capital of the company into shares of larger amount than its existing shares;
 - (b) the conversion of any shares of company into stock;
 - (c) the reconversion of any stock of company into shares;
 - (d) the sub-division of any of the shares of the company into shares of smaller amount; or
 - (e) the conversion of one kind of shares of the company into another kind,

the 'cost of acquisition' means the cost of acquisition of the asset calculated with reference to the cost of acquisition of the shares or stock from which such asset is derived.

In relation to a capital asset, being equity share or shares allotted to a shareholder of a recognised stock exchange in India under a scheme for corporatisation approved by the Securities and Exchange Board of India Act, 1992 (15 of 192), shall be the cost of acquisition of his original membership of the exchange.

Example 3: X bought 100 shares of ₹ 10 each fully paid @ ₹ 15 per share. The company sub-divided shares into shares of ₹ 5 each (fully paid). X later on sold 50 of the shares @ ₹ 8 each.

₹	
Sale proceeds or consideration received 50 x ₹ 8	400
Less : Cost of acquisition: 50 shares now sold by X have been derived from 25 shares which he had originally acquired @ ₹ 15 per share. Cost of acquisition of these 50 shares will be 25 x ₹ 15	375

Circular: No. 31 (LXXVII-5)-D, dated 21.9.1962.

This circular of the department on the "cost of acquisition" is also worth noting:

Where an assessee acquires an asset by inheritance from a person who in turn had also acquired the same by inheritance before 1.1.1954 (now 1.4.1981) the assessee has the option of substituting the fair market value of the asset as at 1.1.1954 (now 1.4.1981) in place of the original cost, if it is to his advantage. On the basis of this a view could be taken as follows:

- (i) *the fair market value of original shares on 1.4.1981 can be adopted if such shares have been substituted or consolidated after that date, and*
- (ii) *the indexation should be made with reference to either the year of acquisition of original shares or 1.4.1981, whichever is later.*

Cost of improvement

Section 55(1)(b) provides that where the capital asset became the property of the previous owner or the assessee before 1.4.1981, the cost of any improvement means all expenditure of a capital nature incurred in making any additions or alterations to the capital asset on or after the said date by the previous owner or the assessee. In other cases, it means all capital expenditure in making any additions or alterations by the assessee after it became his property and where the capital asset became the property of the assessee by any of the modes specified in Section 49(1) by the previous owner as the case may be. If, however, any part of the expenditure is deductible in computing the income chargeable under the head "Interest on securities", "Income from house property", "Profits and gains of business or profession" or "Income from other sources", such expenditure cannot be included as cost of improvement. For example, a house is bought out of borrowed money. The interest paid on the loan till the date of completion of construction has been held to be part of cost of acquisition of the house. But ground rent paid which is deductible while computing income under the head "income from house property" cannot be taken to be cost of improvement and hence cannot be added to the cost of acquisition.

However, the 'Cost of any improvement' at sub-clause (b) of Clause 1 of Section 55, in relation to a capital asset being goodwill of a business, shall be taken to be nil.

5.52 Capital Gains in case of damage or destruction of Capital Asset (w.e.f. Assessment year 2000-01) [Section 45(1A)]

Where any person receives at any time during the previous year any money or other asset under an insurance from an insurer on account of damage to or destruction of, any capital asset, as a result of:

- (i) flood, typhoon, hurricane, cyclone, earthquake, or other convulsion of nature; or

- (ii) riot or civil disturbance; or
- (iii) accidental fire or explosion; or
- (iv) action by an enemy or action taken in combating an enemy (whether with or without a declaration of war),

then, any profits or gains arising from receipt of such money or other asset shall be chargeable to tax under the head 'Capital Gains'. The income shall be deemed to be the income for the previous year in which such money or other asset is received. For computing capital gains, the value of any money or the fair market value of asset received on the date of receipt shall be deemed to be the full value of consideration received or accruing as a result of the transfer of damaged asset.

Advance money received

Section 51 of the Act provides that where any capital asset was on any previous occasion the subject of negotiation for its transfer, any advance or other money received and retained by the assessee in respect of such negotiations shall be deducted from the cost for which the asset was acquired or the written down value or the fair market value, as the case may be in computing the cost of acquisition.

Transfer of Securities held with Depository [Section 45(2A)]

Where any person has had at any time during the previous year any beneficial interest in securities, then, any profits or gains arising from transfer made by the Depository or participant of such beneficial interest in respect of securities shall be chargeable to tax as the income of the beneficial owner of the previous year in which transfer took place and not of the Depository who is deemed to be the registered owner of Securities.

The cost of acquisition and the period of holding of any securities shall be determined on first-in-first-out basis. [vide Circular No. 768, dated 24-6-98, issued by CBDT]

Computation of Capital Gains on purchase by company of its own shares or other specified securities (w.e.f. Assessment year 2000-01)

Where a company purchases its own shares from a shareholder or other specified securities from its holder, then the capital gains shall be chargeable to tax in the hands of transferor. The capital gains shall be computed as provided in Section 48 in the year in which such shares or specified securities are purchased by the company.

CAPITAL GAINS EXEMPT FROM TAX

Under Sections 54, 54B, 54D, 54EC, 54F, 54G and 54H of the Act, capital gains arising from the transfer of certain capital assets are exempt from tax under certain circumstances. These provisions are dealt with section wise below.

Profit on sale of property used for residence (Section 54)

Where any capital gain arises to an assessee, individual or H.U.F., on the transfer of a long-term residential house (either self-occupied or let out), the income of which is chargeable under the head, 'Income from house property', and where the assessee (or in case of his death, his legal representative) has (i) purchased a residential house within a period of one year before such transfer or within a period of two years after such transfer, or (ii) constructed a residential house within three years after such transfer, the capital gain arising on such transfer is to be treated in the following manner:

- (i) The capital gain arising on the transfer of such residential house is exempt to the extent it is re-invested in the purchase or construction of another residential house within the period as aforesaid. If the entire capital gain is re-invested, it is fully exempt from income-tax and not includable in the total income of the assessee. If only a part thereof is re-invested, the balance is chargeable to income-tax. The allotment of

flats under self-financing scheme of Delhi Development Authority is treated as a new construction for the purposes of capital gain exemption (under Section 54).

- (ii) The new residential house so purchased or constructed should not be transferred within a period of three years of its purchase or construction as the case may be. If it is transferred within such period of three years, the cost of the new house so purchased or constructed is to be reduced by the amount of old exempted capital gain. In other words, the old exempted capital gain and new capital gain, if any arising on the transfer of the new residential house, both are chargeable to tax as the income of the previous year in which the new residential house is transferred. If the transfer of the new house is effected after the expiry of three years of its purchase or construction, the cost of the new house so purchased or constructed is not to be reduced by the amount of old exempted capital gain. In other words, the old exempted gain is not taxable in such cases.
- (iii) Where the amount of capital gain which is not appropriated or utilised by the assessee for the purchase of a residential house within one year before the date of the transfer or which is not utilised by him for the purchase or construction of a new residential house before the date for furnishing the return of income (under Section 139), the unutilised amount has to be deposited on or before the due date for furnishing the return of income in an account in any bank or institution specified by the Central Government. The return of income should be furnished along with proof of such deposit. The amount already utilised for the purchase or construction of the new residential house together with the amount so deposited shall be deemed to be the amount utilised for the purchase or construction of the new residential house. Thus, the assessee is allowed exemption in respect of capital gain so utilised or deposited.

The assessee has to utilise the amount so deposited for the purchase or construction of the new residential house within the specified period as aforesaid [under Section 54(1)]. When the deposited amount is not so utilised either wholly or partly for the purchase or construction of the new residential house, the unutilised amount is treated as capital gain of the relevant previous year in which the period of three years from the date of such transfer expires.

Transfer of land used for agricultural purposes (Section 54B)

Where any capital gain either long-term or short-term arises on the transfer of land which, in the two years immediately preceding the date of transfer, was being used by the assessee being an individual or his parents or a Hindu Undivided Family for agricultural purposes and where the assessee has purchased any other agricultural land within a period of two years after the date of its transfer, such capital gain is to be treated as under:

- (i) The capital gain arising on the transfer of old agricultural land is exempt to the extent it is reinvested in the purchase of any other agricultural land within the aforesaid period. If whole capital gain is reinvested, it is fully exempt from income-tax and not includable in the total income of the assessee. If only a part of it has been re-invested, the balance of it is chargeable to income-tax. New land may be in rural or urban area.
- (ii) New agricultural land so purchased should not be transferred within three years of its purchase. If it is sold before the expiry of three years, the cost of the new agricultural land is to be reduced by the amount of old exempted capital gain [Section 54B(1)].
- (iii) The amount of capital gain not utilised by the assessee for purchase of new agricultural land before the date for furnishing the return of his income is to be deposited by him, on or before the due date for furnishing the return of income, in an account in any bank or institution specified by the Central Government. The amount already utilised for the purchase of agricultural land together with the amount so deposited is deemed to be the amount utilised for the purchase of agricultural land. Accordingly, the assessee is allowed exemption in respect of capital gain so utilised or deposited [Section 54B(2)].

The assessee is also required to utilise the amount of deposit for the purchase of agricultural land within the specified period as aforesaid [Section 54B(1)]. If the deposited amount is not so utilised for the purchase of agricultural land, the unutilised amount is treated as capital gain of the relevant previous year in which the period of two years from the date of such transfer expires.

Compulsory acquisition of lands and buildings (Section 54D)

An assessee is entitled to exemption from tax in respect of capital gains arising from the transfer, by way of compulsory acquisition, of any land or building forming part of an industrial undertaking belonging to him provided the following conditions are satisfied:

- (a) The land and buildings form part of an industrial undertaking of the assessee.
- (b) It has been so used for at least two years preceding the date of compulsory acquisition.
- (c) The assessee purchases any other land and building within a period of three years from the date of acquisition or constructed a building within such period.
- (d) The newly acquired lands and buildings are used for the shifting or re-establishment of old industrial undertaking or for setting up new industrial unit.
- (e) The new asset is not transferred by the assessee for a period of three years from the date of acquisition.
- (f) The capital gains are not chargeable to tax to the extent they are utilised in purchasing the land and building.

Consequences if new land or building is transferred within 3 years:

If new land or building is transferred within a period of three years from the date of its purchase or construction, the amount of capital gains arising therefrom, together with the amount of capital gains exempted earlier, will be chargeable to tax in the year of sale of new land and building.

Scheme of deposit

Where the amount of capital gain is not appropriated or utilised by the assessee for purchase of new asset before the date of furnishing the return of his income, it shall be deposited by him on or before the due date of furnishing the return of income, in an account with a bank or institutions specified in, and utilised in accordance with any scheme framed by the Central Government in this regard. The amount already utilised for purchase or construction of the new asset, together with the amount so deposited, shall be deemed to be the amount utilised for the purchase of a new asset. If the amount deposited is not utilised fully for purchase or construction of a new asset within the stipulated period, then the amount not so utilised shall be treated as the capital gain of the previous year in which the period of three years from the date of transfer of original asset expires. In such case the assessee shall be entitled to withdraw such amount in accordance with the aforesaid scheme.

The words '**industrial undertaking**' should be understood to have been used in Section 54D in a wide sense, taking in its fold any project or business a person may undertake. Thus, the 'running of a lodge' can also be said to be an 'industrial undertaking' within the meaning of Section 54D. [*P. Alikunju M.A. Nazeer Cashew Industries v. C/I/T (1987) 166 ITR 804 (Ker)*].

No tax on long-term capital gains if investments made in specified bonds (Section 54EC)

(1) Where the capital gain arises from the transfer of a long-term capital asset (the capital asset so transferred being hereafter in this section referred to as the original asset) and the assessee has, at any time within a period of six months after the date of such transfer, invested the whole or any part of capital gains in the long-term specified asset, the capital gain shall be dealt with in accordance with the following provisions of this section, that is to say:

- (a) if the cost of the long-term specified asset is not less than the capital gain arising from the transfer of the original asset, the whole of such capital gain shall not be charged under Section 45;
 - (b) if the cost of the long-term specified asset is less than the capital gain arising from the transfer of the original asset, so much of the capital gain as bears to the whole of the capital gain the same proportion as the cost of acquisition of the long-term specified asset bears to the whole of the capital gain, shall not be charged under Section 45.
- (2) Where the long-term specified asset is transferred or converted (otherwise than by transfer) into money at any time within a period of three years from the date of its acquisition, the amount of capital gains arising from the transfer of the original asset not charged under Section 45 on the basis of the cost of such long-term specified asset as provided in Clause (a) or, as the case may be, Clause (b) of Sub-section (1) shall be deemed to be the income chargeable under the head "Capital gains" relating to long-term capital asset of the previous year in which the long-term specified asset is transferred or converted (otherwise than by transfer) into money.

Explanation: In a case where the original asset is transferred and the assessee invests the whole or any part of the capital gain received or accrued as a result of transfer of the original asset in any long-term specified asset and such assessee takes any loan or advance on the security of such specified asset, he shall be deemed to have converted (otherwise than by transfer) such specified asset into money on the date on which such loan or advance is taken.

(3) Where the cost of the long-term specified asset has been taken into account for the purposes of Clause (a) or Clause (b) of Sub-section (1)—

- (a) a deduction from the amount of income-tax with reference to such cost shall not be allowed under Section 88 for any assessment year ending before the 1st day of April, 2006;
 - (b) a deduction from the income with reference to such cost shall not be allowed under Section 80C for any assessment year beginning on or after the 1st day of April, 2006.
- (a) "**cost**", in relation to any long-term specified asset, means the amount invested in such specified asset out of capital gains received or accruing as a result of the transfer of the original asset;
 - (b) "**long-term specified asset**" means any bond redeemable after three years issued on or after 1st day of April, 2006.

Benefit of the exemption will be available only if the gains are invested in bonds of NHAI and RECL that are issued on or after 1-4-2006. (w.e.f. A.Y. 2006-07)

Section 54EC is attracted where long term capital asset is transferred. So an assessee can avail benefit of Section 54EC with respect to depreciable asset. [**CIT v. ACE Builders (P) Ltd. (2005) 144 Taxman 855 (Bom.)**].

Capital gains on transfer of certain listed securities or unit, not to be charged in certain cases (Section 54ED).

The benefit of exemption under this section is being withdrawn w.e.f. A.Y. 2007-08 in respect of asset transferred on or after 1-4-2006 as long-term capital gain from such shares/units is fully exempt under Section 10(38) and short-term capital gain from such shares/units is taxable at a special rate of 15%.

Capital gain on the transfer of certain capital assets not to be charged in case of investment in residential house (Section 54F)

Where in the case of an assessee being an individual or a Hindu Undivided Family, the capital gain arises from the transfer of any long-term capital asset, not being a residential house (hereafter in this section referred to as the original asset), and the assessee has, within a period of one year before or two years after the date on which the transfer took place purchased, or has within a period of three years after that date constructed, a residential

house (hereafter in this section referred to as the new asset), the capital gain shall be dealt with in accordance with the following provisions of this section, that is to say:

- (a) if the cost of the new asset is not less than the net consideration in respect of the original asset, the whole of such capital gain shall not be charged under Section 45;
- (b) if the cost of the new asset is less than the net consideration in respect of the original asset, so much of the capital gain as bears to the whole of the capital gain the same proportion as the cost of the new asset bears to the net consideration, shall not be charged under Section 45.

Provided that nothing contained in this section shall apply where:

- (a) the assessee:
 - (i) owns more than one residential house, other than the new asset, on the date of transfer of the original asset; or
 - (ii) purchases any residential house, other than the new asset, within a period of one year after the date of transfer of the original asset; or
 - (iii) constructs any residential house, other than the new asset, within a period of three years after the date of transfer of the original asset; and
- (b) the income from such residential house, other than the one residential house owned on the date of transfer of the original asset, is chargeable under the head "Income from house property".

For the purposes of this section "Net consideration" means full value of the consideration received or accruing as a result of transfer of the capital asset as reduced by any expenditure incurred wholly and exclusively in connection with such transfer.

Forfeiture of the Exemption:

If the assessee sells the newly purchased or constructed house within a period of 3 years of its purchase or construction, as the case may be, the old exempted long-term capital gain would be chargeable to tax as long-term capital gain in the previous year in which the house so purchased or constructed is transferred. If the transfer of the new residential house is effected after the expiry of three years of its purchase or construction, the old exempted long term capital gain is not chargeable to tax [Section 54F(3)].

Sub-section (4) of Section 54F further provides that the net consideration which is not appropriated by the assessee for the purchase of a residential house within one year before the date of such transfer, or which is not utilised by him for the purchase or construction of a residential house before the date of furnishing the return of income (under Section 139), has to be deposited by him before the due date of furnishing the return of income [under Section 139(1)] in an account in any bank or institution specified by the Central Government. The amount already utilised by him for the said purpose together with the amount so deposited is deemed to be the cost of the new asset. Accordingly, the assessee is entitled to exemption in respect of the capital gain on such basis. The return of income filed by the assessee has to be accompanied by proof of such deposit.

The assessee is required to utilise the amount of deposit for the purchase or construction of a residential house within the aforesaid specified period [under Section 54F(1)]. If the deposited amount is not so utilised, wholly or partly, for the purchase/construction of new house within the specified period, the excess amount of exemption shall be treated as capital gains of the previous year in which the period of three years from the date of the transfer of the original asset expires.

What is required under this section is that the assessee has used the property for residence and non use of it by the assessee due some reasons will not disentitle him from eligibility under Section 54F. [Amit Gupta v. CIT (2006) 6 SC 403 (Del.)].

Capital gain on shifting of industrial undertaking from urban area (Section 54G)

Exemption under this section is available subject to satisfaction of the following conditions:

- (i) A capital asset (being plant, machinery, land or building or any right in land or building) used for the purpose of an industrial undertaking situated in an urban area is transferred. For this purpose, "urban area" means any such area within the limits of a municipal corporation or municipality as the Central Government may, having regard to the population, concentration of industries, need for proper planning of the area and other relevant factors, by general or special order, declare to be an urban area for the purpose of this section.
- (ii) The transfer is effected in the course of, or in consequence of, the shifting of such industrial undertaking (hereinafter referred to as the original asset) to any area other than an urban area.
- (iii) The assessee has within a period of one year before or 3 years after the date on which the transfer took place:
 - (a) purchased new machinery or plant for the purposes of business of the industrial undertaking in the area to which the said undertaking is shifted;
 - (b) acquired building or land or constructed building for the purposes of his business in the said area;
 - (c) shifted the original asset and transferred the establishment to such area; and
 - (d) incurred expenses on such other purpose as may be specified in a scheme framed by the Central Government for the purposes of this section.

How much exemption?

If the conditions given above are satisfied the capital gains will be exempt to the extent as follows:

If the amount of the capital gain is greater than the cost and expenses incurred in relation to all or any of the purposes mentioned in clauses (a) to (d) (such cost and expenses being hereinafter in this section referred to as the new asset), the difference between the amount of the capital gain and the cost of the new asset shall be charged under Section 45 as the income of the previous year; and for the purpose of computing in respect of the new asset any capital gain arising from its transfer within a period of 3 years of its being purchased, acquired, constructed or transferred, as the case may be the cost shall be nil.

If the amount of the capital gain is equal to, or less than the cost of the new asset, the capital gain shall not be charged under Section 45; and for the purpose of computing in respect of the new asset any capital gain arising from its transfer within a period of 3 years of its being purchased, acquired, constructed or transferred, as the case may be, the cost shall be reduced by the amount of the capital gain.

Scheme of deposit

Where the amount of capital gain is not appropriated or utilised by the assessee for purchase or construction of the new asset within one year before the date on which the transfer of the original asset took place or before the date of furnishing the return of income, it shall be deposited by him on or before the due date of furnishing the return of income, in an account with a bank or institution specified in and utilised in accordance with any scheme framed by the Central Government in this regard. The amount already utilised for purchase or construction of the new asset, together with the amount so deposited, shall be deemed to be the amount utilised for the purchase of a new asset. If the amount deposited is not utilised fully for purchase or construction of a new asset within the stipulated period, then the amount not so utilised shall be treated as the capital gain of the previous year in which the period of 3 years from the date of transfer of original asset expires. In such cases the assessee shall be entitled to withdraw such amount in accordance with the aforesaid scheme.

Exemption of capital gain on transfer of assets of shifting of industrial undertaking from urban area to a Special Economic Zone [Section 54GA]

The exemption is available to all categories of assesses in respect of capital gain arising on the transfer of fixed assets other than furniture and fittings of industrial undertaking effected in the course of shifting of such industrial undertaking to any Special Economic Zone.

The conditions for claiming exemptions are as under:

- (i) The transfer is effected in the course of or in consequence of shifting the undertaking from an urban area to any Special Economic Zone. The special Economic Zone may be developed in any urban area or any other area.
 - 1. Any other area means an area not declared as an urban area.
 - 2. **‘Urban Area’** means any such area within the limits of a municipal corporation or municipality, as the Central Government may, having regard to the population, concentration of industries, need for proper planning of the area and other relevant factors, by general or special order, declare to be an urban area for the purposes of this sub-section.
 - 3. **“Special Economic Zone”** means each Special Economic Zone notified under the proviso to Sub-section (4) of Section 3 and Sub-section (1) of Section 4 of the Special Economic Zone Act, 2005 (including Free Trade and Warehousing Zone) and includes an existing Special Economic Zone. [Section 2(za) of the Special Economic Act, 2005].
- (ii) Asset transferred is machinery, plant, building, land or any right in building or land used for the business of industrial undertaking in an urban area;
- (iii) The capital gain arising on the asset transferred may be short-term or long-term capital gain. Normally, it will be short-term capital gain because most of the assets of the industrial undertaking will be depreciable assets;
- (iv) The capital gain is utilized within 1 year before or 3 years after the date of transfer for the specified purpose.

Specified purpose includes the following:

- (a) for purchase of new machinery or plant for the purpose of business of the Industrial Undertaking in the Special Economic Zone to which the said undertaking is shifted;
- (b) acquisition of building or land or construction of building for the purposes of the assessee’s business in the Special Economic Zone;
- (c) expenses on shifting of the old undertaking and its establishment to the Special Economic Zone; and
- (d) incurring of expenditure on such other purposes as specified by the Central Government for this purpose.

Capital Gain on Transfer of residential House Property (Section 54GB)

The Government had announced National Manufacturing Policy (NMP) in 2011, one of the goals of which is to incentivize investment in the Small and Medium Enterprises (SME) in the manufacturing sector.

With effect from assessment year 2013-14, a new section 54GB has been inserted so as to provide rollover relief from long term capital gains tax to an individual or an HUF on sale of a residential property (house or plot of land) in case of re-investment of sale consideration in the equity of a new start-up SME company in the manufacturing sector which is utilized by the company for the purchase of new plant and machinery.

- (1) Where, the capital gain arises from the transfer of a long-term capital asset, being a residential property (a house or a plot of land), owned by the eligible assessee (herein referred to as the assessee); and

- (ii) the assessee, before the due date of furnishing of return of income under sub-section (1) of section 139, utilises the net consideration for subscription in the equity shares of an eligible company (herein referred to as the company); and
- (iii) the company has, within one year from the date of subscription in equity shares by the assessee, utilised this amount for purchase of new asset,

then, instead of the capital gain being charged to income-tax as the income of the previous year in which the transfer takes place, it shall be dealt with in accordance with the following provisions of this section, that is to say,

- (a) if the amount of the net consideration is greater than the cost of the new asset, then, so much of the capital gain as it bears to the whole of the capital gain the same proportion as the cost of the new asset bears to the net consideration, shall not be charged under section 45 as the income of the previous year; or
- (b) if the amount of the net consideration is equal to or less than the cost of the new asset, the capital gain shall not be charged under section 45 as the income of the previous year.

(2) The amount of the net consideration, which has been received by the company for issue of shares to the assessee, to the extent it is not utilised by the company for the purchase of the new asset before the due date of furnishing of the return of income by the assessee under section 139, shall be deposited by the company, before the said due date in an account in any such bank or institution as may be specified and shall be utilised in accordance with any scheme which the Central Government may, by notification in the Official Gazette, frame in this behalf and the return furnished by the assessee shall be accompanied by proof of such deposit having been made.

(3) For the purposes of sub-section (1), the amount, if any, already utilised by the company for the purchase of the new asset together with the amount deposited under sub-section (2) shall be deemed to be the cost of the new asset:

Provided that if the amount so deposited is not utilised, wholly or partly, for the purchase of the new asset within the period specified in sub-section (1), then,

- (i) the amount by which
 - (a) the amount of capital gain arising from the transfer of the residential property not charged under section 45 on the basis of the cost of the new asset as provided in sub-section (1), exceeds
 - (b) the amount that would not have been so charged had the amount actually utilised for the purchase of the new asset within the period specified in sub-section (1) been the cost of the new asset,
- shall be charged under section 45 as income of the assessee for the previous year in which the period of one year from the date of the subscription in equity shares by the assessee expires; and
- (ii) the company shall be entitled to withdraw such amount in accordance with the scheme.

(4) If the equity shares of the company or the new asset acquired by the company are sold or otherwise transferred within a period of five years from the date of their acquisition, the amount of capital gain arising from the transfer of the residential property not charged under section 45 as provided in sub-section (1) shall be deemed to be the income of the assessee chargeable under the head "Capital gains" of the previous year in which such equity shares or such new asset are sold or otherwise transferred, in addition to taxability of gains, arising on account of transfer of shares or of the new asset, in the hands of the assessee or the company, as the case may be.

(5) The provisions of this section shall not apply to any transfer of residential property made after the 31st day of March, 2017.

(6) For the purposes of this section,

- (a) "eligible assessee" means an individual or a Hindu undivided family;
- (b) "eligible company" means a company which fulfils the following conditions, namely:
 - (i) it is a company incorporated in India during the period from the 1st day of April of the previous year relevant to the assessment year in which the capital gain arises to the due date of furnishing of return of income under sub-section (1) of section 139 by the assessee;
 - (ii) it is engaged in the business of manufacture of an article or a thing;
 - (iii) it is a company in which the assessee has more than fifty per cent share capital or more than fifty per cent voting rights after the subscription in shares by the assessee; and
 - (iv) it is a company which qualifies to be a small or medium enterprise under the Micro, Small and Medium Enterprises Act, 2006 (27 of 2006);
- (c) "net consideration" shall have the meaning assigned to it in the Explanation to section 54F;
- (d) "new asset" means new plant and machinery but does not include
 - (i) any machinery or plant which, before its installation by the assessee, was used either within or outside India by any other person;
 - (ii) any machinery or plant installed in any office premises or any residential accommodation, including accommodation in the nature of a guest-house;
 - (iii) any office appliances including computers or computer software;
 - (iv) any vehicle; or
 - (v) any machinery or plant, the whole of the actual cost of which is allowed as a deduction (whether by way of depreciation or otherwise) in computing the income chargeable under the head "Profits and gains of business or profession" of any previous year.

EXTENSION OF TIME FOR ACQUIRING NEW ASSET OR DEPOSITING OR INVESTING AMOUNT OF CAPITAL GAIN (SECTION 54H)

Section 54H has been inserted by the Finance (No. 2) Act, 1991 with effect from 1.10.1991. This section states that where the transfer of the original asset is by way of compulsory acquisition under any law and the amount of compensation awarded for such acquisition is not received by the assessee on the date of such transfer, the period of acquiring the new asset by the assessee referred to in Sections 54, 54B, 54D, 54EC and 54F or for depositing or investing the amount of capital gain shall be extended. This extended period shall be reckoned from the date of receipt of such compensation.

BONUS SHARES AND CAPITAL GAINS

The Finance Acts 1994 and 1995 have brought about sweeping changes in computation of capital gains of shares. Cost of original shares is the actual price paid therefor. Cost of rights shares is the actual price paid therefor. Cost of bonus shares is nil. In other words, cost of original shares or rights shares will not rub off on to the bonus shares and its cost will be deemed to be nil as it is obtained free of cost just as cost of rights shares is not allowed to be influenced by the price paid for the original shares. In other words, from the assessment year 1996-97, there would be a compartmentalised approach to computation of capital gains in respect of shares with original shares and its offshoots i.e. rights and bonus remaining separate from one another. Any amount realised on relinquishment of rights will be taxable in full as cost of such relinquishment is also deemed to be nil.

COMPUTATION OF CAPITAL GAINS IN RESPECT OF DEPRECIABLE ASSETS (SECTION 50)

The capital gains on depreciable assets are computed as under:

- (1) Find out the written down value on the first day of the previous year relevant to the assessment year of all those depreciable assets on which the depreciation is allowed at the same rate. All such assets are known as 'block of assets'.
- (2) If any new asset of the same block is purchased during the previous year, the cost of such asset shall be included in the balance at step (1).
- (3) If any asset is sold out of such block during the previous year, the net consideration shall be deducted from the balance under (2).
- (4) Computation of depreciation at the prescribed rate on the balance under (3) and deduction thereof from the same balance.
- (5) The balance under (4) shall be the written down value of the 'block of assets' for the next year.

It means if the net consideration of an asset out of the block is less than the balance under (2), there would be no capital gain. If the net consideration of an asset is more than the balance under (2) (the value of all assets in the block) the excess shall be deemed to be short term capital gain. If all the assets of the block are sold in the previous year and the net consideration is less than the balance under (2), the loss shall be deemed to be short-term capital loss.

Where subject matter of transfer is an asset on which deduction on account of depreciation under Section 32(1)(i) has been claimed and obtained by the assessee in any previous year, the cost of acquisition of the asset shall be the written down value as defined in Section 43(6).

COST OF ACQUISITION AND CAPITAL GAIN IN CASE OF DEPRECIABLE ASSETS OF ELECTRICITY COMPANIES [SECTION 50A]

Where the capital asset is an asset in respect of which an undertaking engaged in generation or generation and distribution of power has claimed depreciation at certain percentage on actual cost under Section 32(1)(i), in any previous year, than for purpose of computing capital gain on such assets, the cost of acquisition shall be the actual cost at which the asset was acquired by such undertaking and it shall not be the written down value as adjusted, as is applicable for other assessee's. However, on such transfer, the difference between the actual cost and the WDV of such asset shall be balancing charge taxable under Section 41(2). Further in this case, there can be long-term capital gains if the asset is held for more than 36 months.

SPECIAL PROVISIONS FOR COMPUTATION OF CAPITAL GAINS IN CASE OF SLUMP SALE [SECTION 50B]

Any profits or gains arising from the slump sale, effected in the previous year, shall be chargeable to income-tax as capital gains arising from the transfer of long-term capital assets and shall be deemed to be the income of the previous year in which the transfer took place. However, if the undertaking is owned and held by the assessee for not more than 36 months immediately preceding the date of transfer, then such slump sale will result into short-term capital gain. On the other hand, if such undertaking is owned and held by the assessee for more than 36 months immediately preceding the date of transfer, it shall be deemed to be long-term capital gains irrespective of the fact that such undertaking has acquired certain assets which are held for less than 36 months.

Meaning of slump sale [Section 2(42C)]

'Slump sale' means the transfer of one or more undertakings as a result of the sale for a lump sum consideration without values being assigned to the individual assets and liabilities in such sales. In other words it is a sale where the assessee transfers one or more undertaking as a whole including all the assets and liabilities as a

going concern. The consideration is fixed for the whole undertaking and received by the transferor it is not fixed for each of the asset of the undertaking as a whole by way of such sale.

Thus it may be noted that the undertaking as a whole or the division transferred shall be a capital asset.

COMPUTATION OF CAPITAL GAIN IN REAL ESTATE TRANSACTION [SECTION 50C]

Section 50C makes a special provision for determining the full value of consideration in cases of transfer of immovable property. It provides that where the consideration declared to be received or accruing as a result of the transfer of land or building or both, is less than the value adopted or assessed by any authority of a State Government (i.e. "stamp valuation authority") for the purpose of payment of stamp duty in respect of such transfer, the value so adopted or assessed shall be deemed to be the full value of the consideration, and capital gains shall be computed on the basis of such consideration under Section 48 of the Income-tax Act.

FAIR MARKET VALUE TO BE FULL VALUE OF CONSIDERATION IN CERTAIN CASES (SECTION 50D)

Capital gains are calculated on transfer of a capital asset, as sale consideration minus cost of acquisition. In some recent rulings, it has been held that where the consideration in respect of transfer of an asset is not determinable under the existing provisions of the Income-tax Act, then, as the machinery provision fails, the gains arising from the transfer of such assets is not taxable.

Section 50D has been inserted to provide that fair market value of the asset shall be deemed to be the full value of consideration if actual consideration is not attributable or determinable.

REFERENCE TO VALUATION OFFICER (SECTION 55A)

With a view to ascertaining the fair market value of a capital asset, the concerned Assessing Officer may refer the valuation of the capital asset to a Valuation Officer appointed by the Income-tax Department in the following cases:

- (a) Where the value of the asset as claimed by the assessee is in accordance with the estimate made by a registered valuer (who works in a private capacity under a licence issued by the Board and his valuation is not binding on the Assessing Officer), but the Assessing Officer is of the opinion that the value so claimed is less than its fair market value (upto june 30, 2012) w.e.f 1st july 2012, the Assessing Officer is enabled to make a reference to the Valuation Officer where in his opinion the value declared by the assessee is at variance from the fair market value [Section 55A(a)].
- (b) Where the Assessing Officer is of the opinion that the fair market value of the asset exceeds the value of the asset by more than ₹ 25,000 or 15 per cent of the value claimed by the assessee whichever is less [Section 55A(b)(i) read with Rule 111AA].
- (c) Where the Assessing Officer is of the opinion that, having regard to the nature of an asset and relevant circumstances, it is necessary so to make a reference to the Valuation Officer [Section 55A(b)(ii)].

It may be noted that in a case where the assessee has opted for substitution of the cost of acquisition of an asset by its fair market value as on 1.4.1981, the fair market value as claimed by him may be higher than its actual fair market value. The provisions of Section 55A(a) and (b)(i) are, therefore, not applicable to such a case. It is, however, open to the Assessing Officer to make a reference to the Valuation Officer under Section 55A(b)(ii). The Central Government has appointed a large number of Valuation Officers under Section 12A of the Wealth-tax Act and these Valuation Officers exercise their functions in relation to the categories of asset for which they have been appointed. The jurisdiction of the Valuation Officers has been defined in Rule 3A of the Wealth-tax Rules. The Valuation Officer exercise the same jurisdiction for income-tax purposes also.

Note that in cases covered by Section 55A(a) and (b)(i) above it is the duty of the Assessing Officer to refer the valuation of the capital asset in question to the Valuation Officer attached to the department and not to decide the question of the valuation on his own.

Illustration:

A has the following incomes for the previous year 2013-14:

	₹	
Business income	(–) 30,000	(viz. business loss of 30,000)
Short-term capital gains	6,000	
Long-term capital gains	1,90,000	

A deposits ₹ 9,000 in public provident fund account. You are required to find out his tax liability for the assessment year 2014-15.

Solution:

Computation of net Income of Mr. A for the assessment year 2014-15

	₹	₹
Business Income		(–) 30,000
Capital gain		
- Short-term	6,000	
- Long-term	1,90,000	1,96,000
		<u>1,66,000</u>

Computation of Tax Liability for the assessment year 2013-14

	Income other than long-term capital gain	Long-term capital gain
	Rs.	Rs.
Net Income (a)	(–) 24,000	1,90,000
Tax on (a)	Nil	2,060

Notes :

1. If the net income (other than long-term capital gain) is below the amount of first slab which is not taxable (i.e. ₹ 2,00,000), then the long-term capital gain is to be reduced by the amount by which the total income (other than long-term capital gain) falls short of the maximum amount which is not chargeable tax.
2. In this case, net income (other than long-term capital gain) is (–) ₹24,000 which will be allowed for carried forward i.e. not to be deducted from ₹2,00,000. Therefore, long-term capital gain shall be reduced by ₹ 2,00,000. Thus, no tax shall be leviable on long-term capital gain.

COMPUTATION OF CAPITAL GAIN IN THE CASE OF CONVERSION OF CAPITAL ASSET INTO STOCK-IN-TRADE [SECTION 45(2)]

The provisions of section 45(2) are given below –

- With effect from the assessment year 1985-86, conversion on investment into stock-in-trade of a business carried on by that taxpayer' is treated as transfer under section 2(47) in the year in which conversion takes place.
- The notional capital gain arising from transfer by way of conversion of capital asset into stock-in-trade is chargeable to tax in the year in which stock-in-trade is sold [sec. 45(2) inserted with effect from the assessment year 1985-86].
- For the purposes of computing the capital gain in such cases, the fair market value of the capital asset on the date on which it was converted or treated as stock-in-trade shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of the capital assets.

TRANSFER OF CAPITAL ASSET BY A PARTNER TO A FIRM [SECTION 45(3)]

Section 45(3) is applicable if the following conditions are satisfied -

Condition 1 : A person is a partner in a firm or he becomes a partner in a firm.

Condition 2 : He transfers a capital asset (maybe short-term/ long-term, depreciable / non depreciable) to the firm. If the asset transferred is not a capital asset, then section 45(3) is not applicable. For instance, if a personal car is transferred, then section 45(3) is not applicable as a personal car is not a “capital asset”.

Condition 3 : The transferred may be by way of his capital contribution or otherwise.

If all these conditions are satisfied then -

- (a) the capital gain is chargeable to tax in the previous year in which such transfer takes place ; and
- (b) the amount recorded in the books of account of the firm as the value of capital asset shall be taken as full value of consideration received as a result of transfer.

Note :

1. The above rules are also applicable when a member transfers a capital asset to an association of persons/ body of individuals.
2. These rules are not applicable when a member transfers a capital asset to a company or a co-operative society.

DISTRIBUTION OF CAPITAL ASSET ON DISSOLUTION [SECTION 45(4)]

Section 45(4) is applicable if the following conditions are satisfied -

Condition 1 : The taxpayer is a firm

Condition 2 : It transfers capital assets (maybe short-term /long-term, depreciable / non-depreciable). If the asset transferred is not a capital asset, then section 45(4) is not applicable. For instance, if rural agricultural land situated in India is transferred (Which is not a “capital assets”), then section 45(4) is not applicable.

Condition 3 : The transfer is by way of distribution of capital assets on the dissolution of the firm or otherwise.

If the above conditions are satisfied, then -

- (a) the capital gains is taxable in the hands of the firm ;
- (b) it is taxable as income of the year in which the transfer takes place;
- (c) for computing capital gain the fair market value of the asset on the date of transfer is taken as full value of consideration.

Note :

1. The above rules are also applicable when an asset is transferred by an association of persons or body of individuals.

2. These rules are not applicable when an asset is transferred by a company or a co-operative society.
3. If a firm distributes a depreciable asset, the capital gain/loss shall always be short-term capital gain/loss.

COMPUTATION OF CAPITAL GAINS IN THE CASE OF COMPULSORY ACQUISITION OF AN ASSET [SECTION 45 (5)]

The provisions of section 45(5) are given below –

WHEN SECTION 45(5) IS APPLICABLE – In any of the following case, section 45(5) is applicable –

1. When the transfer of a capital asset is by way of compulsory acquisition under any law.
2. When a capital asset is transferred (not by way of compulsory acquisition) and the consideration is approved or determined by the Central Government (not by a State Government) or the Reserve Bank of India.

When initial compensation is received – If any of the above two cases, capital gain shall be computed as follows –

Different questions	Tax treatment
What is taken as sale consideration.	Initial compensation is taken as full value of sale consideration.
In which year it is chargeable to tax.	Capital gain is chargeable to tax in the previous year in which initial compensation (or part hereof) is first received.

Notes :

1. Capital gain is not taxable in the year in which capital asset is transferred but it is taxable in the first year in which initial compensation (or part thereof) is first received.
2. If Compensation is subsequently increased, then the tax consequences are given in the para given below.

When enhanced compensation is received –

If any compensation is enhanced by a court, Tribunal or any authority, then it will be taxable as follows -

1. It shall be taxable in the previous year in which enhanced compensation is received by the assessee. It will be taxable in the year of receipt even if appeal is pending in any court or Tribunal.
2. In this case, cost of acquisition and the cost of improvement shall be taken as nil.
3. Litigation expenses for getting the compensation enhanced are deductible as expenses on transfer.
4. If the enhanced compensation is received by any other person (because of the death of the transferor or for any other reason), it is taxable as income of the recipient.
5. Where such amount of the compensation is subsequently reduced by any court, Tribunal or other authority, the capital gain of that year, in which the additional compensation received was taxed, shall be recomputed accordingly.

The aforesaid rules are applicable whether the compensation is enhanced by the court/ Tribunal / authority on an appeal of the taxpayer or because of any other reason.

Computation of capital gains in the case of non-resident [First proviso to sec. 48] –

First proviso to section 48 is applicable only in the case of non-resident. Under this provision, capital gain is calculated in foreign currency in some cases.

Conditions - To Avail to benefit of this provision, the following conditions should be satisfied -

Condition 1 : The taxpayer is non-resident (maybe an Indian or foreign citizen, or a corporate-assessee or a non-corporate assessee but not being an assessee covered by section 115AC and 115AD).

Condition 2 : He acquires shares in (or debentures of) an Indian company (may be public limited or private limited) by utilising foreign currency.

Condition 3 : The asset may be short-term or long-term.

Rule of computation - If the aforesaid conditions are satisfied, then the following procedure shall be adopted to determine capital gain (it maybe noted that the procedure given below is applicable without any exception whenever the above conditions are satisfied)-

1. Capital gain shall be computed in the same foreign currency which was initially utilised in acquiring shares or debentures.
2. Capital gain so calculated in the foreign currency shall be recovered into Indian currency.
3. The benefit of indexation shall not be available.
4. The aforesaid manner of computation of capital gain shall be applicable in respect of capital gain accruing or arising from every re-investment thereafter in (and sale of) shares in (or debentures of) an Indian Company.
5. The aforesaid mode of computation is applicable only when the above-mentioned conditions are satisfied. In no other case, the above procedure is applicable.

LESSON ROUND UP

- Sections 45 to 55A of the Income-tax Act, 1961 deal with capital gains. Section 45 of the Act, provides that any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in Sections 54, 54B, 54D, 54EC, 54ED, 54F, 54G, 54GA and 54H be chargeable to income-tax under the head “Capital Gains” and shall be deemed to be the income of the previous year in which the transfer took place.
- Section 2(14) of the Income-tax Act defines the term “capital asset” to means Property of any kind held by an assessee whether or not connected with his business or profession but does not include **any stock-in-trade, personal effects , agricultural land in India, 6½ per cent Gold Bonds, Special Bearer Bonds , Gold Deposit Bonds.**
- The essential requirement for the incidence of tax on capital gains is the transfer of a ‘capital asset’. Any capital gain arising as a result of transfer of a short-term capital asset is known as short-term capital gain. “**Short term**” **capital asset** means a capital asset held by an assessee for not more than thirty-six months immediately preceding the date of its transfer. In the case of capital assets (being equity or preference share in a company) held by an assessee for not more than 12 months immediately prior to its transfer.
- Assets other than short-term capital assets are known as ‘**long-term capital assets**’ and the gains arising therefrom are known as ‘long-term capital gains’. Section 48 of the Act provides that the income chargeable under the head ‘capital gains’ shall be computed by deducting from the full value of consideration received or accruing as a result of the transfer of the capital asset the amount of expenditure incurred wholly and exclusively in connection with such transfer and the cost of acquisition of the capital asset and the cost of any improvement thereto.
- ‘**Cost of acquisition**’ of goodwill of a business or a right to manufacture, produce or process any article or thing, tenancy rights, stage carriage permits or loom hours is in the case of acquisition of

such asset by the assessee by purchase from a previous owner, cost of acquisition means the amount of the purchase price; and in any other case cost of acquisition shall be Nil.

- **Cost of improvement** means all capital expenditure in making any additions or alterations by the assessee after it became his property and where the capital asset became the property of the assessee by any of the modes specified in Section 49(1) by the previous owner as the case may be.
- Under Sections 54, 54B, 54D, 54EC, 54F, 54G and 54H of the Act, capital gains arising from the transfer of certain capital assets are exempt from tax under certain circumstances.

SELF TEST QUESTIONS

These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation.

MULTIPLE CHOICE QUESTIONS

1. Short-term capital loss can be set-off from –
 - (a) Short-term capital gains
 - (b) Long-term capital gains
 - (c) Both short-term and long-term capital gains
 - (d) Any income of the previous year.
2. which of the following shall not be a personal effect;
 - (a) Mobile for personal use
 - (b) Computer for personal use
 - (c) Furniture for personal use
 - (d) Jewellery for personal use
3. The Cost of Improvement in relation to a capital asset being goodwill of a business shall be taken to be;
 - (a) the incurred cost
 - (b) the incurred cost after indexation
 - (c) Nil
 - (d) the cost incurred by the previous owner

TRUE AND FALSE

1. Income from transfer of self-generated goodwill of a profession is not chargeable to tax under the head 'capital gains'.
2. Indexation of cost of acquisition is necessary for short-term capital gain.
3. Paintings are considered as Personal effects.
4. Any transfer of a capital assets under a gift or will or an irrevocable trust is not regarded as transfer.

SHORT NOTES

1. Capital assets
2. Taxation of zero coupon bonds

3. Capital gains in case of damage or destruction of capital asset(iv) Tax on income of foreign institutional investors from capital gains arising from transfer of their securities.

DISTINGUISH BETWEEN

1. 'Exemption to capital gains under section 54G' and 'exemption to capital gains under section 54GA'.
2. 'Long-term capital gain' and 'short-term capital gain'.

ELABORATIVE

1. Explain with the help of suitable illustration how capital gains are computed under section 45(2) in case of conversion of capital asset into stock-in-trade.
2. What are 'capital assets'? What items are not included in capital assets?

PRACTICAL QUESTIONS

1. Vinod sells the following assets on 10th January, 2014 :

	Goodwill of Business (Self-generated)	Equity Shares in R Ltd.	Jewellery	Plot of land
	(₹)	(₹)	(₹)	(₹)
Sales consideration	6,00,000	7,50,000	25,00,000	25,00,000
Cost of acquisition	40,000	80,000	2,50,000	Nil
Transfer expenses	4,000	–	25,000	–
Date of acquisition	04.05.1989	04.03.1997	04.02.1992	–

Based on the following indices, compute income from capital gains of Vinod for the assessment year 2014-15 taking into consideration the facts that the business was set-up in November, 1999 and that he purchased a plot of land for ₹8,00,000 and jewellery for ₹2,00,000 on 10th March, 2013.

2. Anurag sells a plot of land on 8th July, 2013 for ₹40 lakh and paid brokerage on its sale @1%. He purchased this plot on 19th December, 1987 for ₹4,20,000. On 1st February, 2014, he purchased a residential house for ₹15 lakh. He owns one residential house on 8th July, 2013. Find out the amount of capital gains chargeable to tax for the assessment year 2014-15.

ANSWERS/HINTS

Multiple choice question

1(c); 2(d); 3(c)

True and False

1 True; 2 False; 3 False; 4 True

Practical questions

1. ₹ 3,97,860, ₹ 5,26,525, ₹ 14,04,648, assume that assessee had purchased new plot of land for construction of residential house property. Further, assume that equity shares are not listed at any stock exchange
2. ₹ 9,78,036.

Test Your Knowledge

1. (c)

SUGGESTED READINGS

1. Dr. V.K. Singhania : Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.

2. Girish Ahuja and Ravi Gupta : Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.

Lesson 4

Part V – Income from Other Sources

LESSON OUTLINE

- Income chargeable under the head 'Income from other Sources'
- Taxation of Dividends
- Meaning of the term 'Dividend' [Section 2(22)]
- Deductions allowable in computing income from other sources
- Amounts not Deductible (Section 58)
- Interest on Securities Section 56(2)
- Tax Concessions.
- Lesson Round Up
- Self Test Questions

LEARNING OBJECTIVES

Income chargeable under Income-tax Act, which does not specifically fall for assessment under any of the heads discussed earlier, must be charged to tax as "income from other sources". This head is thus a residuary head of income under which income can be computed only after deciding whether the particular item of income is otherwise assessable under any of the first four heads. In addition to the taxation of income not covered by the other heads, Section 56(2) specifically provides certain items of incomes as being chargeable to tax under the head in every case. The provisions for computation of income from other sources are covered under sections 56 to 59. While section 56 defines the scope of income chargeable under this head, sections 57 and 58 specify the basis of computation of such income.

At the end of this lesson, you will learn (i) which are the income chargeable under the head income from other sources, (ii) which are the incomes specifically taxable under this head, (iii) what are admissible deductions, (iv) which are the inadmissible deductions and (v) what are the provisions of taxability of gift in kind or in cash from relative or unrelated persons.

The incomes which are neither covered under the head salary, house property, business income or capital gains shall be taxable under head Income from other sources. This head of income is a residual head because it covers all other incomes which are uncovered and which are not exempt from tax.

INCOME CHARGEABLE UNDER THE HEAD 'INCOME FROM OTHER SOURCES'

Income chargeable under Income-tax Act, which does not specifically fall for assessment under any of the heads discussed earlier, must be charged to tax as "income from other sources". This head is thus a residuary head of income under which income can be computed only after deciding whether the particular item of income is otherwise assessable under any of the first four heads. In addition to the taxation of income not covered by the other heads, Section 56(2) specifically provides certain items of incomes as being chargeable to tax under the head in every case.

The following shall be chargeable to Income Tax under the head Income from other sources: –

(a) Dividends [Section 56(2)(i)]

Dividend income other than divided referred under section 10(34) shall be included under income from other sources.

(b) Keyman Insurance policy

Amount received under a Keyman insurance Policy, including bonus on each Policy, if it is not taxable under any other head of income shall be chargeable under Income from other sources.

(c) Winnings from lotteries [Section 56(2)(ib)]

Any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature shall be chargeable to tax under Income from other sources.

Winnings from lotteries, crossword puzzles, races, (including horse races), card games and other games of any sort or from gambling or betting of any form or nature whatsoever, are specifically chargeable to tax as income from other sources even if the assessee deriving such income claims to carry on any trade or adventure in these activities as part of his business.

The entire income of winnings, without any expenditure or allowance or deductions under Sections 80C to 80U, will be taxable. **However, expenses relating to the activity of owning and maintaining race horses are allowable.** Further, such income is taxable at a special rate of income-tax i.e., 30% + surcharge + cess @ 3% [Section 115BB]

(d) Contribution to Provident fund

Income of the nature referred to in Section 2(24)(x) (relating to certain contributions to any provident fund or superannuation fund or any fund set up under the provisions of the ESI Act or any other fund for the welfare of such employees received by the assessee from his employees in his capacity as an employer) will be chargeable to income-tax under the head "income from other sources" if such income is not chargeable to income-tax under the head "profits and gains of business or profession". But if the employer deposits such amount on or before due date of deposit applicable for such contribution, he will be allowed a deduction on account of the same. [Section 56(2)(ic)].

(e) Income by way of interest on securities

if the income by way of interest on securities is not chargeable to income-tax under the head 'Profits and gains of business or profession' than such income shall be taxable under Income from other sources.

(f) Income from hiring of machinery etc. [Section 56(2)(ii)]

Income from machinery, plant or furniture belonging to the assessee and let on hire if the income is not chargeable to income-tax under the head "profits and gains of business or profession" shall be taxable under Income from other sources.

(g) Hiring out of building with machinery etc. [Section 56(2)(iii)]: Where an assessee lets on hire machinery, plant or furniture belonging to him and also building and the letting of the building is inseparable from the letting of the said machinery, plant or furniture, the income from such letting, if it is not chargeable to income-tax under the head “Profits and gains of business or profession” shall be taxable under Income from other sources.

(h) Money Gifts:

Where any sum of money, the aggregate value of which exceeds fifty thousand rupees, is received without consideration, by an individual or a Hindu undivided family, in any previous year from any person or persons **on or after the 1st day of April, 2006 but before 1st day of October, 2009**, the whole of the aggregate value of such sum shall be taxable under the head Income from other sources. [Section 56(2)(vi)]

Provided that this clause shall not apply to any sum of money received

- (a) from any relative; or
- (b) on the occasion of the marriage of the individual; or
- (c) under a will or by way of inheritance; or
- (d) in contemplation of death of the payer; or
- (e) from any local authority as defined in the Explanation to clause (20) of section 10; or
- (f) from any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution referred to in clause (23C) of section 10; or
- (g) from any trust or institution registered under section 12AA.

Explanation: For the purposes of this clause, relative means

- (i) spouse of the individual;
- (ii) brother or sister of the individual;
- (iii) brother or sister of the spouse of the individual;
- (iv) brother or sister of either of the parents of the individual;
- (v) any lineal ascendant or descendant of the individual;
- (vi) any lineal ascendant or descendant of the spouse of the individual;
- (vii) spouse of the person referred to in clauses (ii) to (vi).]

(i) Gifts in Cash or in Kind:

Where an individual or a Hindu undivided family receives, in any previous year, from any person or persons on or after the 1st day of October, 2009 [Section 56(2)(vii)]

- (a) any sum of money, without consideration, the aggregate value of which exceeds fifty thousand rupees, the whole of the aggregate value of such sum shall be chargeable to tax under this head.
- (b) (i) any immovable property received without consideration, the stamp duty value of which exceeds fifty thousand rupees, the stamp duty value of such property shall be taxable under income from other sources.
 - (ii) any immovable property received for a consideration which is less than the stamp duty value of the property by an amount exceeding fifty thousand rupees, the stamp duty value of such property as exceeds such consideration shall be chargeable to tax under income from other sources.

Where the date of the agreement fixing the amount of consideration for the transfer of immovable property and the date of registration are not the same, the stamp duty value on the date of the agreement may be taken.

However, this exception shall apply only in a case where the amount of consideration referred to therein, or a part thereof, has been paid by any mode other than cash on or before the date of the agreement for the transfer of such immovable property.

- (c) any property, other than immovable property
 - (i) without consideration, the aggregate fair market value of which exceeds fifty thousand rupees, the whole of the aggregate fair market value of such property;
 - (ii) for a consideration which is less than the aggregate fair market value of the property by an amount exceeding fifty thousand rupees, the aggregate fair market value of such property as exceeds such consideration.

shall be chargeable to tax under Income from other sources.

Provided that where the stamp duty value of immovable property as referred to in subclause (b) is disputed by the assessee on grounds mentioned in sub-section (2) of section 50C, the Assessing Officer may refer the valuation of such property to a Valuation Officer, and the provisions of section 50C and sub-section (15) of section 155 shall, as far as may be, apply in relation to the stamp duty value of such property for the purpose of sub-clause (b) as they apply for valuation of capital asset under that section:

Provided further that this clause shall not apply to any sum of money or any property received

- (a) from any relative; or
- (b) on the occasion of the marriage of the individual; or
- (c) under a will or by way of inheritance; or
- (d) in contemplation of death of the payer or donor, as the case may be; or
- (e) from any local authority as defined in the Explanation to clause (20) of section 10; or
- (f) from any fund or foundation or university or other educational institution or hospital or other medical institution or any trust or institution referred to in clause (23C) of section 10; or
- (g) from any trust or institution registered under section 12AA.

Explanation:

- (a) *“fair market value” of a property, other than an immovable property, means the value determined in accordance with the method as may be prescribed;*
- (b) *“property” means the following capital asset of the assessee, namely: (substituted for “means” by the Finance Act, 2010, w.r.e.f. 1-10-2009).*
 - (i) *immovable property being land or building or both;*
 - (ii) *shares and securities;*
 - (iii) *jewellery;*
 - (iv) *archaeological collections;*
 - (v) *drawings;*
 - (vi) *paintings;*
 - (vii) *sculptures; or*
 - (viii) *any work of art or*
 - (ix) *bullion*

- (c) “stamp duty value” means the value adopted or assessed or assessable by any authority of the Central Government or a State Government for the purpose of payment of stamp duty in respect of an immovable property;
- (d) “relative” means, –
- (i) in case of an individual
 - (A) spouse of the individual;
 - (B) brother or sister of the individual;
 - (C) brother or sister of the spouse of the individual;
 - (D) brother or sister of either of the parents of the individual;
 - (E) any lineal ascendant or descendant of the individual;
 - (F) any lineal ascendant or descendant of the spouse of the individual;
 - (G) spouse of the person referred to in items (B) to (F); and
 - (ii) in case of a Hindu undivided family, any member thereof

(j) Shares as gift:

Where a firm or a company not being a company in which the public are substantially interested, receives, in any previous year, from any person or persons, on or after the 1st day of June, 2010, any property, being shares of a company not being a company in which the public are substantially interested, [Section 56(2)(viiia)]

- (i) without consideration, the aggregate fair market value of which exceeds fifty thousand rupees, the whole of the aggregate fair market value of such property;
- (ii) for a consideration which is less than the aggregate fair market value of the property by an amount exceeding fifty thousand rupees, the aggregate fair market value of such property as exceeds such consideration.

shall be chargeable to tax under Income from other sources.

However, this clause shall not apply to any such property received by way of a transaction not regarded as transfer under clause (via) or clause (vic) or clause (vicb) or clause (vid) or clause (vii) of section 47.

(k) Share premiums in excess of the fair market value to be treated as income [Section 56(2)(viib)]

Where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares shall be taxable under Income from other sources.

However, that this clause shall not apply where the consideration for issue of shares is received:

- (i) by a venture capital undertaking from a venture capital company or a venture capital fund; or
- (ii) by a company from a class or classes of persons as may be notified by the Central Government in this behalf.

Explanation- For the purposes of this clause,

- (a) the fair market value of the shares shall be the value

- (i) as may be determined in accordance with such method as may be prescribed; or
 - (ii) as may be substantiated by the company to the satisfaction of the Assessing Officer, based on the value, on the date of issue of shares, of its assets, including intangible assets being goodwill, know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature,
- whichever is higher;
- (b) "venture capital company", "venture capital fund" and "venture capital undertaking" shall have the meanings respectively assigned to them in clause (a), clause (b) and clause (c) of Explanation to clause (23FB) of section 10

(I) income by way of interest received on compensation or on enhanced compensation referred to in clause (b) of section 145A shall be chargeable to tax under Income from other sources. [Section 56(2)(viii)].

Besides the above, **there are some other incomes which are also chargeable under the head 'Income from Other Sources'**. For example:

- (1) Any fees or commission received by an employee from a person other than his employer.
- (2) Any annuity received under a Will. It does not include an annuity received by an employee from his employer.
- (3) All interest other than interest on securities, e.g. interest on bank deposits, interest on loan, etc.
- (4) Income of a tenant from sub-letting the whole or a part of the house property.
- (5) Remuneration received by a teacher or a lawyer for doing examination work.
- (6) Income of Royalty.
- (7) Director's fees.
- (8) Rent of land not appurtenant to any building.
- (9) Agricultural Income from land situated outside India.
- (10) Income from markets, ferries and fisheries, etc.
- (11) Income from leasehold property.
- (12) Remuneration received for writing articles in Journals.
- (13) Income from undisclosed sources.
- (14) Interest received by an employee on his own contributions to an unrecognised provident fund.
- (15) Casual income in excess of ₹ 5,000, or (₹ 2,500 in case of winning from horse race, etc.) as the case may be.
- (16) Salary of a Member of Parliament, Member of Legislative Assembly or Council.
- (17) Interest received on securities of co-operative society.
- (18) Family pension received by the widow of an employee of the U.N.O. is exempt. Similarly the family pension of gallantry awardee is exempt.
- (19) Amount withdrawn from deposit in National Savings Scheme, 1987 on which deduction under Section 80CCA has been allowed including interest thereon.
- (20) Gratuity received by a director who is not an employee of the company.
- (21) Director's commission for giving guarantee to bank.
- (22) Director's commission for underwriting shares of a new company.

Further, under the provisions of Section 60 to 65 an assessee may be chargeable to tax in respect of income arising to other persons, e.g. spouse or minor children. In such cases, the income in question will be first computed under the appropriate head after allowing various deductions and includible in the total income of the assessee under the head "income from other sources". In other words, wherever the assessee is taxable in respect of income of some body else, the income must be charged to tax in the hands of the assessee only under this head even if the income is of a character which would otherwise fall for assessment under any other head of income.

TAXATION OF DIVIDENDS

Section 10(34) exempts dividend as defined in Section 115-O from tax in the hands of recipients thereof. Section 115-O, the main operative provision in the newly introduced Chapter XII-D, however, calls upon a company declaring/distributing dividend to pay 15% plus surcharge plus Education & Secondary and Higher Education Cess by way of tax on distributed profits in addition to what it is liable by way of tax on its income in the normal course. This tax on distribution paid by a company is not available for deduction under any provision of the Act. Dividend for the purpose of Section 115-O and by extension for the purpose of Section 10(33) is the same as defined in Section 2(22) except that clause (e) thereof shall not be treated as dividend for both these purposes. In other words the scheme of taxation of dividend can be summarised as under:

- (a) Dividends or any other income distributed by UTI or a foreign company, are chargeable to tax under this head.
- (b) In respect of dividend under clause (e) of Section 2(22) the status quo continues i.e. the specified persons receiving loans and advances from a closely-held company will continue to pay tax as earlier on these receipts and the company giving such loans and advances will not be liable to tax like it was earlier. It may be pointed out that tax liability under clause (e) of Section 2(22) would be extremely unlikely now that there is no need for the dominant shareholders of closely-held companies to combine dividend with the character of loan or advance to avoid tax liability because dividend is no longer taxable in the hands of shareholders. Against this backdrop, the discussion hereunder may be studied.

Meaning of the term 'Dividend' [Section 2(22)]

The term 'dividend' is ordinarily used to refer to any distribution made by a company to its shareholders out of its profits in proportion to the number of shares held by the shareholder concerned in the company. Apart from the distribution made by the company, any division of profit between the members who earned the same would also be treated as dividend under the general meaning of expression. For purposes of income-tax, the definition of dividend is given in Section 2(22) of the Income-tax Act. The definition, although not exhaustive and comprehensive, is having the effect of over-riding anything else to the contrary contained in any other law for the time being in force. The definition given in the Income-tax Act is enumerative and inclusive in nature and does not precisely specify as to what exactly is meant by the term dividend. Consequently, any money received by a shareholder which may not fall within the various items specified in the Income-tax Act may still be considered and taxable as dividend except in cases where a different interpretation or inference could be had in the circumstances of the case.

According to the definition in the Income-tax Act, 'Dividend' includes the following items:

- (a) **Any distribution by a company of accumulated profits, whether capitalised or not**, if such distribution entails the release by the company to its shareholders of all or any part of the assets of the company; Current profit would be part of accumulated profits but subsidy on Capital Account cannot be treated as accumulated profits. – *CIT v. Rajasthan Wires (P) Ltd.* (2003) 130 Taxman 93 DP (Mag.).
- (b) **Any distribution, by a company to its shareholders, of debentures debenture stock or deposit certificates in any form**, whether with or without interest and any distribution to its preference shareholders of shares **by way of bonus** to the extent to which the company possesses accumulated profits, whether capitalised or not;

- (c) **Any distribution made to the shareholders of a company on its liquidation**, to the extent to which such distribution is attributable to the accumulated profits of the company immediately before its liquidation, whether capitalized or not;
- (d) **Any distribution to its shareholders by a company on the reduction of its share capital**, to the extent to which the company possesses accumulated profits, whether capitalised or not;
- (e) **Any payment made by a company, in which the public are not substantially interested of any sum** whether representing a part of the assets of the company or otherwise made after the 31st day of May, 1987, by way of advance or loan to a shareholder, being a person who is the beneficial owner of shares (not being shares entitled to a fixed rate of dividend whether with or without right to participate in profits), holding not less than ten per cent of the voting power, or to any concern in which such shareholder is a member or a partner and in which he has a substantial interest (hereinafter in this clause referred to as the said concern), or any payment by any such company on behalf of or for the benefit of the shareholder having substantial interest in the company to the extent to which the company possesses accumulated profits.

But, Sub-section (22) to Section 2 specifically excludes the following:

- (i) Any distribution made by a company in accordance with (c) or (d) above in respect of any share issued for full cash consideration in cases where the shareholder is not entitled, in the event of liquidation, to participate in the surplus assets of the company;
- (ii) Any distribution made in accordance with items (c) and (d) above in so far the distribution is attributable to the capitalised profits of the company representing bonus shares allotted to its equity shareholders after 31.3.1964 and before 1.4.1965;
- (iii) Any advance or loan made by a company to its shareholder the said concern, i.e, a HUF firm, an AOP or, BOI or a company in the ordinary course of its business in cases where lending of money is a substantial part of the business of the company;
- (iv) Any dividend paid by a company which is set off by the company against the whole or any part of any sum previously paid by it and treated as a dividend under item (e) above to the extent to which it is so set off;
- (v) Any payment made by a company on purchase of its own shares from a shareholder in accordance with the provisions of Section 77A of the Companies Act, 1956;
- (vi) Any distribution of shares pursuant to a demerger by the resulting company to the shareholders of the demerged company (whether or not there is a reduction of capital in the demerged company).

The enumeration given above represents various payments which are notionally or by fiction of law, treated as dividend and which, in the absence of specific provision may not be chargeable to tax as dividend income in the hands of shareholders. The distributions or payments constituting dividend referred to above apply only to payments or distributions made by a company as defined in Section 2(17) of the Income-tax Act.

Since the meaning and scope of the term 'dividend' used in the income-tax Act is much wider than what is commonly understood, it covers not only payments as dividends made by a company in accordance with the provisions of company law but also various other payments which may not amount to dividend under company law. In order to be chargeable to tax as dividend, it is not essential that the dividend must be paid only in cash although the provisions of Company Law require that a dividend must always be paid in cash or by cheque. In all cases where a dividend is paid in any form other than cash, say in the form of goods, securities or shares, even of another company, the amount of dividend which is liable to income-tax must be taken to be the market value of the thing received as dividend.

For instance, if 'A' company distributes dividends to its shareholders in the form of shares of its wholly owned subsidiary company 'B' at the face value of ₹ 100 each while the market value is ₹ 150 per share, the liability to tax on the part of the company would be on the basis of the market value of the share. For this purpose, it is immaterial

if the shares are such that a part of the shares cannot be divided for being utilized towards tax deductible at source. The company's liability to pay distribution tax is not in any way affected or reduced by the fact that the dividend in question is paid in kind or is calculated on a basis different from what the income-tax law provides.

It is likely that the company may not comply with some of the provisions of Company Law in the matter of declaration and payment of dividends. Even in such cases, non-observance of the various formalities or the provisions of Company Law by the company concerned would not in any way affect the taxability of the amount as dividend in the hands of the Company. Consequently, if a company, in violation of law, distributes dividends out of its share premium account, the Company would still be taxable regardless of the fact that the payment in question does not come out of the revenue profits of the declaring company.

In the process of capitalisation of the accumulated profits and reserves, a company may normally resort to the issue of bonus shares. This is mostly done in cases when a company is prosperous and has a large surplus and after some time it is decided to convert the surplus into capital and divide the capital amongst the members in proportion to their rights. This is done by issuing fully paid shares representing the increased share capital. Bonus shares are issued out of credit balance to the Profit and Loss Account and out of reserves and the shareholders to whom the shares are issued, have to pay nothing. The purpose is to capitalise profits which may be otherwise available for distribution. If the Articles of Association of a company permit, a company can capitalise profits and reserves and issue fully paid shares on a nominal value equal to the amount capitalised to its shareholders. This is permissible subject, however, to the provisions of Sections 78 and 205 of the Companies Act and guidelines issued in this regard by the SEBI.

When bonus shares are issued by a company to its equity shareholders the company is not chargeable to distribution tax on the value of the bonus shares. This is because of the fact that according to Section 2(22)(a), the distribution of accumulated profits of a company would result in dividend only if there is release of the company's assets as a result of such distribution. This is because of the fact that the effect of the bonus issue is that the profits remain in the hands of the company as capital and the shareholders receive only paper certificates as evidence of their interest in the additional capital so set aside or capitalised. The transaction takes nothing out of the company's coffers and puts nothing into the shareholders' pockets and the only result is that the company which, before the resolution, could have distributed the profits by way of dividend or carried it to a reserve account, comes under an obligation to retain it permanently as its capital. Therefore, bonus shares given by a company in proportion to the holding of equity capital by a shareholder are, in the absence of any express provision to the contrary, not liable to be taxed as income. Therefore, bonus shares are not dividend or income at all when they are issued to the holders of equity or ordinary shares.

However, the utilisation of the accumulated profits for the purpose of starting a subsidiary company and issue of shares of the subsidiary company to its own shareholders as bonus shares would constitute dividend, as there would be a release of assets by the parent company.

In cases where bonus shares are issued to the holders of preference shares, the market value of the bonus shares would be liable to distribution tax as income by way of dividends in the hands of the Company in view of the specific provisions contained in Section 2(22)(b). However, even in the case of preference shareholders, the liability to tax would be only to the extent to which the distribution is made by the company out of its accumulated profits, whether capitalised or not.

Any distribution made by a company out of its accumulated profits would constitute dividend if the distribution is made on the reduction of share capital of the company. This reduction may take place even in cases where bonus shares are issued by capitalising the accumulated profits and reserves of the company and later on paying off the bonus shares. This may also take place in cases where the accumulated profits are applied first towards making the partly-paid shares into fully-paid ones and later, the amount of the fully-paid shares is reduced on reduction of share capital. Even in the case of liquidation of a company, any distribution made by the liquidator (less than the capital subscribed) would constitute income from dividend to the extent to which the distribution could be attributable to the accumulated profits of the company which may or may not have been capitalised during the existence of the company.

The 'accumulated profits' for the purpose do not include any capital gain arising to the company before 1.4.1946 or after 31.3.1948 and before 1.4.1956 because during these periods capital gains were not chargeable to tax and were consequently not treated as part of the profits of the company. In the case of every company, the expression accumulated profits must be taken to include all profits of the company upto the date of distribution or payment including reserves kept for specific purposes so long as such reserves constitute an appropriation of profit instead of being a charge against profit. For instance, amount represented by the balance to the credit of the development rebate reserves account would form part of the accumulated profits of the company; but if a company follows the process of crediting the amount of depreciation reserve account such a reserve would not form part of the accumulated profits of the company because depreciation is a charge against the profits and not an appropriation of profits. In the case of a company in liquidation, accumulated profits should be taken to include all the profits of the company upto the date of liquidation. But in cases where the liquidation is consequent upon the compulsory acquisition of its undertaking by a government or a corporation owned or controlled by the government under any law for the time being in force, accumulated profits should not be taken to include any profits of the company prior to three successive accounting years immediately preceding the accounting year in which such acquisition of the company was made by the government or other statutory corporation.

Any payment of loan or other advance by a company, in which the public are not substantially interested, to its shareholder who has substantial interest in the company would constitute dividend to the extent to which the company possesses accumulated profits which may or may not have been capitalised. Similarly, any payment made by a closely held company for the individual benefit of a shareholder who has a substantial interest in the company would also constitute dividend chargeable to tax in the hands of the shareholder. For instance, if a closely held company makes payment of insurance premium on behalf of the shareholder or lends money to the shareholder or makes any advance on his behalf, the shareholder would be deemed to have received a dividend and be chargeable to income-tax thereon. The expression 'shareholder' for this purpose should be taken to mean only the registered shareholder and not the beneficial shareholder. Consequently in cases where the loans are given by a closely held company to a Hindu Undivided Family of which the registered shareholder is a member, such loans would not be taxable as dividend since the Hindu Undivided Family is not registerable as shareholder of the company. If, however, the loans are advanced to the registered shareholders, the loans would be taxable as dividend even though the registered shareholder may not have any personal or beneficial interest in the shares concerned. The liability to tax in respect of such loans, advances, other payments made by a closely held company to its substantial shareholder, would be only to the extent to which the company possesses accumulated profits, which may or may not have been capitalised.

In the case of *CIT v. V. Damodaran* (1980) 121 ITR 572, the Supreme Court held that 'accumulated profits' cannot include current profits, and therefore, the profits earned by the company during the year in which loans are advanced to a shareholder cannot be regarded as accumulated profits for deemed dividends. Therefore, if the company at the time of giving the loan or making the advance does not have any accumulated profit, there would be no liability to tax because of the specific exemption given in the section. Similarly, any loan by a closely held company to its substantial shareholder which is set off against any loan or money borrowed by or due to the company from the shareholder would also be not liable to income-tax as dividend. In cases where a company possesses accumulated profits and loans are given to the shareholder, the liability to tax on the part of the shareholder would not be restricted to the amount of the accumulated profits in proportion to his shareholding in the company. Thus, if a company has accumulated profits of ₹1,00,000 and a shareholder holding 20% of the equity shares is given a loan of ₹80,000, the shareholder cannot claim that his liability to tax would be only to the extent of ₹ 20,000, he would be taxable on the entire amount of loan received from the company although if the company had declared dividend at an Annual General Meeting, he would have been entitled to receive a maximum of ₹ 20,000 only.

It may be summarize as under:

- the types of dividend contemplated by the first four clauses viz. (a) to (d) of Section 2(22) are exempt in the hands of the shareholders.
- the last category viz. 2(22)(e) which has applicability only to the shareholders of closely-held companies or dividend from a foreign company, be taxable in the hands of shareholders.

DEDUCTIONS ALLOWABLE IN COMPUTING INCOME FROM OTHER SOURCES

The income chargeable under the head "Income from other sources" is the income after making the following deductions:

1. From interest on securities [Section 57(i) and (iii)]: any reasonable sum paid by way of commission or remuneration to a banker or any other person for the purpose of realising such interest on behalf of the assessee. Interest on money borrowed for investment in securities can be claimed as a deduction.

During the previous year the assessee withdrew a fixed deposit before maturity and had to refund ₹ 3,500 to the bank. The amount withdrawn was invested in shares. It was held by Karnataka High Court under the earlier regime that the amount paid to the Bank was an expenditure laid out wholly and exclusively for the purpose of earning the dividend income and deduction thereof while computing income from dividend is in order. *C.I.T. v. Master Sabrya M. Pai* (1984) 150 ITR 251 (Kar.).

2. From the contributions received by employer from employees towards P.F./Superannuation/other funds: [Section 57(ia)]

In the case of income of the nature referred to in Section 2(24)(x), which is chargeable to income-tax under the head "Income from other sources" deduction shall be allowable in accordance with the provisions of Section 36(1)(va), i.e., if the employer has credited the employee's accounts in the respective funds with the amounts of contributions received, the employer shall be allowed credit thereof.

3. Income derived from letting [Section 57(ii)]: Where income is derived from letting out of machinery, plant or furniture on hire and also buildings where the letting of building is inseparable from the letting of such machinery, plant or furniture and the income from such letting is not chargeable to Income-tax under the head "Profits and Gains of Business or profession", the following expenses incurred in respect of those assets:

- (a) Current repairs of buildings.
- (b) Insurance premium against risk of damage or destruction of the premises.
- (c) Repairs and insurance of machinery, plant or furniture.
- (d) Depreciation.

Where the expenses referred to at (a) to (d) hereinabove are incurred on property used partly for the business of the assessee, a proportionate deduction shall be allowed.

4. Income in the nature of family pension [Section 57(IIa)]: Where a regular monthly amount is payable by an employer to a person belonging to the family of an employee in the event of his death, i.e., 'family pension', a sum equal to 33-1/3% of the income or ₹ 15,000, whichever is less, is allowable as a deduction.

All these expenses will be allowed only when the prescribed particulars are furnished by the assessee.

5. Interest on compensation or enhanced compensation [Section 56(2)(viii)]: a deduction of a sum equal to 50% of such income and no deduction shall be allowed under any other clause of this section.

6. Other deductions [Section 57(iii)]: Any other expenditure (not being in the nature of capital expenditure) laid out or expended wholly and exclusively for the purpose of making or earning such income. [*Smt. Virmati Ramkrishna v. C.I.T.* (1981) 131 ITR 659(Guj)]

Conditions to be satisfied for claiming deductions

Deductions under this clause will, therefore, be **allowed only if** the following **conditions are satisfied**:

- (a) The expenditure is laid out wholly and exclusively for the purpose of earning such income. If the purpose of earning income is coupled with some other extraneous purpose, it will not be possible to say that the deduction under Section 57 (iii) is earned by the assessee. [*Smt. Padmavati Jaykrishna v. C.I.T.* (1975) 101 ITR 153].

- (b) It is not in the nature of capital expenditure.
- (c) It is not a personal expenditure.
- (d) It is incurred in the accounting year itself and not in any prior or subsequent year. [C.I.T. v. *Basant Rai Takhat Singh* (1922) ITR 197].

The section does not say that the expenditure shall be deductible only if income is made or earned. Interest on moneys borrowed for investment in shares which had not yielded any income was admissible as a deduction under the section. [C.I.T. v. *Gopal* (1978) 111 ITR 86].

Note: In computing the income by way of dividends of a foreign company, no deduction will be allowed under Section 57.

AMOUNTS NOT DEDUCTIBLE (SECTION 58)

The following amounts shall not be deducted in computing income chargeable under the head 'Income from other sources':

In the case of any assessee:

- (i) Any personal expenses of the assessee.
- (ii) Any interest chargeable under the Income-tax Act which is payable outside India and from which income-tax has not been paid or deducted at source.
- (iii) Any payment which is chargeable under the head "Salaries" if it is payable outside India unless tax has been paid thereon or deducted therefrom at source.
- (iv) Any expenditure referred to in Section 40A of Income-tax Act.

Section 58(3) lays down that in the case of a foreign company, the provisions of Section 44D will apply while computing income under this head.

No deduction is allowed in respect of any expenditure or allowance in computing the income by way of winnings from lotteries crossword puzzles races (including horse races) card games and other games of any sort or from gambling or betting of any form or nature whatsoever. The prohibition however will not apply in respect of income of an assessee who is owner of horses maintained for running in horse races [Section 58(4)]. The winnings are now taxed at the rate of 30%. The amount is taxable at source and it does not matter whether amount goes to one or more recipients. Similarly the amount spent in buying of in fructuous tickets is not deductible as the gross amount will be taxed.

TAX CONCESSIONS

The word "security" has not been defined by the Income-tax Act. Therefore, its natural meaning as well as the meaning, as interpreted in the case laws, has to be adopted.

The Shorter Oxford English Dictionary defines "security" as : "a document held by a creditor as guarantee of his right to payment. This implies that unless the payment of debt is secured in some way, a mere "debt" is not a security.

In ***Singer v. Williams* (1921) 1 AC 41**, Lord Cave pointed out that the word "security" denotes a debt or claim, the payment of which is in some way secured. Where the word is used in its normal sense, some form of secured liability is postulated. The word "securities" must be construed in the above defined sense and does not include shares or stock in a company".

The following amounts shall not be deducted in computing income chargeable under the head 'Income from other sources':

In the case of any assessee:

- (i) Any personal expenses of the assessee.
- (ii) Any interest chargeable under the Income-tax Act which is payable outside India and from which income-tax has not been paid or deducted at source.
- (iii) Any payment which is chargeable under the head "Salaries" if it is payable outside India unless tax has been paid thereon or deducted therefrom at source.
- (iv) Any expenditure referred to in Section 40A of Income-tax Act.

A. Exempted Interest [Section 10(4)]

- (i) In the case of a non-resident, any income by way of interest on the securities or bonds notified by the Central Government in the Official Gazette, including income by way of premium on the redemption of such bonds.

No securities or bonds will be specified by the Central Govt. for this purpose on or after 1.6.2002.

- (ii) In case of an individual any income by way of interest on moneys standing to his credit in a Non-resident (External) Account in any bank in India in accordance with the Foreign Exchange Regulation Act, 1973 and the Rules made thereunder.

Provided that such individual is a person resident outside India as defined in Section 2(q) of the said Act or is a person who has been permitted by the Reserve Bank of India to maintain such account.

B. Exempted Interest [Section 10(15)]

The interest income from the following securities enumerated specifically at clause 15 of Section 10 of the Income-tax Act is exempted. Hence, the interest thereon shall not be included in the income of the assessee.

- (i) Income by way of interest, premium on redemption or other payment on such securities, bonds, annuity certificates, savings certificates, other certificates issued by the Central Government and deposits as the Central Government may, by notification in the Official Gazette, specify in this behalf, subject to such conditions and limits as may be specified in the said notification.
- (ii) In the case of an individual or a Hindu Undivided family, interest on such Capital Investment Bonds as the Central Government may, by notification in the Official Gazette, specify. (No bonds will be notified by the Central Govt. on or before June 1, 2002)
- (iia) In the case of an individual or a Hindu Undivided family, interest on the notified Relief Bonds.
- (iib) In the case of : (a) a non-resident Indian, being an individual owning the bonds; or (b) a nominee or survivor of the non-resident Indian; or (c) the donee, being an individual, to whom the bonds have been gifted by the non-resident Indian, the interest received thereon shall be exempt if the bonds are purchased by the non-resident Indian, in foreign exchange and the interest and principal received thereon, whether on maturity or otherwise, is not allowed to be taken out of India. The benefit does not cease even if the non-resident Indian subsequently acquires the status of a resident. But, in the event of premature encashment thereof, the benefit shall cease from the previous year in which the encashment is made.
- (iii) Interest on securities held by the Issue Department of the Central Bank of Ceylon constituted under the Ceylon Monetary Law Act, 1949.
- (iiia) Interest payable to any bank incorporated in a country outside India and authorised to perform central

banking functions in that country or any deposits made by it, with the approval of the RBI, with any scheduled bank.

- (iva) Interest payable by Government or a local authority on moneys borrowed by it before June 1, 2001 from or debts owed by it to sources outside India.
- (ivb) Interest payable by an industrial undertaking in India on moneys borrowed by it before June 1, 2001 under a loan agreement entered into with such financial institution in a foreign country as may be approved in this behalf by the Central Government by general or special order.
- (ivc) Interest payable by an industrial undertaking in India on any moneys borrowed or debt incurred by it before June 1, 2001 in a foreign country in respect of purchase outside India of raw materials or components or capital plant and machinery to the extent to which such interest does not exceed the amount of interest calculated at the rate approved by the Central Government in this behalf having regard to terms of the loan or debt and its repayment. Purchase, includes Hire Purchase Agreement or a lease agreement with an option to purchase such plant and machinery.
- (ivd) Interest payable by the Industrial Finance Corporation of India or the IDBI or the Industrial Credit and Investment Corporation of India or Export-Import Bank of India, or the National Housing Bank or the Small Industries Development Bank of India on any moneys borrowed before June 1, 2001 from sources outside India.
- (ive) Interest payable by any other financial institutions established in India or a banking company on any moneys borrowed before June 1, 2001 from sources outside India under an approved loan agreement.
- (ivf) Interest at the rate approved by the Central Govt. payable by an industrial undertaking in India on any moneys borrowed by it in foreign currency from sources outside India under an approved loan agreement.
- (ivfa) Interest payable by a scheduled bank to a non-resident or a person not ordinarily resident on deposits in foreign currency where the acceptance of such deposits by the bank is approved by the Reserve Bank of India.
- (ivg) Interest payable by a public company formed and registered in India, and eligible for deduction under Section 36(1)(viii) with the main objective of carrying on business of providing long term finance for construction or purchase of houses in India for residential purposes on any moneys borrowed by it in foreign currency from sources outside India under an approved loan agreement before the 1st day of June, 2003, to the extent to which such interest does not exceed the amount of interest calculated at the rate approved by the Central Government.
- (ivh) Interest payable by public sector companies on certain specified bonds and debentures subject to such conditions, including the condition that the holder of such bonds or debentures registers his name and the holding with that company, as may be specified by the Central Government by notification in the Official Gazette.
- (ivi) Interest payable by Government on deposits made by an employee of the Central or State Government, or a public sector company out of moneys due to him on account of his retirement, whether on superannuation or otherwise. To be eligible for exemption, the deposit must have been made by the employee in accordance with a scheme notified by the Central Government.
- (ivj) Interest on securities held by the Registrar, Supreme Court, in Reserve Bank's SGL Account No. SL/DHO48.

C. Assessee outside the scope of tax liability in respect of Interest on Securities

Where the securities are held by any of the following persons, interest thereon shall not be included in their income for income-tax purposes:

- (i) Any authority constituted in India for the purpose of dealing with and satisfying the need for housing accommodation or for the purposes of planning, development or improvement of cities, towns and villages [Section 10(20A)].

- (ii) Approved scientific research association [Section 10(21)].
- (iii) Approved games associations or institutions [Section 10(23)].
- (iv) Any Regimental Fund or Non-public Fund [Section 10(23AA)].
- (v) An institution existing solely for the development of Khadi or Village industries [Section 10(23B)].
- (vi) Authority established for the development of Khadi and Village Industries [Section 10(23BB)].
- (vii) Any body or authority constituted for the administration of public religious trusts or endowments [Section 10(23BBA)].
- (viii) European Economic Community [Section 10(23BBB)].
- (ix) – The Prime Minister's National Relief Fund; or
 - The Prime Minister's Fund (Promotion of Folk Art); or
 - The Prime Minister's Aid to Students Fund; or
 - The National Foundation for Communal Harmony; or
 - any university or other educational institution existing solely for educational purposes and not for purposes of profits, which is wholly or substantially financed by the government; or
 - any hospital or other institution for the reception and treatment of persons suffering from illness or mental defectiveness or for the reception and treatment of persons during convalescence or of persons requiring medical attention or rehabilitation, existing solely for philanthropic purposes and not for the purposes of profits and which is wholly or substantially financed by the government; or
 - any university or other educational institution existing solely for educational purposes and not for purposes of profit if the aggregate annual receipts of such university or educational institution do not exceed the amount of annual receipts as may be prescribed.

Illustration

Mr. Ashok who draws a salary of ₹ 25,000 p.m. received the following gifts during the previous year 2013-14 :

- (i) Gift of Jewellery fair market value of which is ₹ 3,00,000 on 17.5.2013 from her fiancee.
- (ii) Gift of ₹ 51,000 each received from her 4 friends on the occasion of her marriage on 21.10.2013.
- (iii) Gift of ₹ 5,00,000 on 16.4.2013 from a friend.
- (iv) Gift of ₹ 60,000 on 22.11.2013 from her father's brother.
- (v) Gift of ₹ 1,00,000 on 25.11.2013 from her mother's sister.
- (vi) Gift of ₹ 50,000 on 1.12.2013 from her husband's friend.
- (vii) Gift of ₹ 28,000 on 15.12.2013 from her brother's father in law.
- (viii) Gift of ₹ 21,000 on 25.12.2013 from her mother's friend.
- (ix) Gift of ₹ 1,31,000 from her husband's brother.
- (x) Scholarship of ₹ 1,10,000 from a charitable institution registered under section 12AA.
- (xi) Gift of ₹ 30,000 from her employer.
- (xii) Gift of immovable property from her friend whose stamp duty value is ₹ 5,00,000.

Solution

Particulars	Amount in ₹
<i>Income under the head salary</i>	
Salary 25000×12	3,00,000
Add: Cash gift from employer	<u>30,000</u>
	<u><u>3.30,000</u></u>
<i>Income from other sources</i>	
(1) <i>Gift of Money</i>	
(i) Gift received from her 4 friends are exempt as they have been received on the occasion of marriage	—
(ii) Gift from friend is includable	5,00,000
(iii) Gift from her father's brother is exempt as the donor is covered in the definition of relative	—
(iv) Gift from her mother's sister is exempt as the donor is covered in the definition of relative	—
(v) Gift of ₹ 50,000 from her husband's friend on 1.12.2013 is taxable as aggregate sum of money received during the year exceeds ₹ 50,000.	50,000
(vi) Gift from her brother's father in law is taxable as the donor is not covered in the definition of relative	28,000
(vii) Gift of ₹ 21,000 from her mother's friend is includable as aggregate sum of money received during the year exceeds ₹ 50,000.	21,000
(viii) Gift from husband's brother is exempt as the donor is covered in the definition of relative	—
(ix) Gift from her employer is taxable as Income from salary	—
(x) Gift in the form of scholarship from charitable institution registered under section 12AA	exempt
(2) <i>Gift of movable property</i>	
Gift of jewellery is taxable	3,00,000
(3) <i>Gift of Immovable property</i>	
Gift of immovable property received from her friend	5,00,000
Total Income	17,29,000

Illustration

The following incomes are received by Dr. Shyam during financial year 2013-14

	₹
(i) Director's fees	5,000
(ii) Income from agricultural land in Pakistan	15,000
(iii) Rent from Let Out of land in Pathankot	20,000
(iv) Interest on deposit with HDFC Bank	1,000
(v) Dividend from Indian company	5,000

(vii) Rent from subletting a house	28,000
(viii) Other expenses on sublet house	1,000
(ix) Rent payable by Dr. Shayam for the sublet house	12,000
(x) Winning from horse race (gross)	15,000
(xi) Interest on securities (gross)	2,500

You are required to calculate income from other sources of Dr. Shayam for the assessment year 2014-15.

Solution

(i) Director's fees	5,000
(ii) Income from agricultural land in Pakistan	15,000
(iii) Rent from Let Out of land in Pathankot	20,000
(v) Interest on deposit with HDFC Bank	1,000
(vi) Dividend from Indian company	Exempt
(vii) Rent from subletting a house	28,000
Less: Rent payable for the sublet house	12,000
Other expenses	<u>1,000</u>
(x) Winning from horse race	15,000
(xi) Interest on securities	<u>2,500</u>
Income from other sources	<u>73,500</u>

LESSON ROUND UP

- Income chargeable under Income-tax Act, which does not specifically fall for assessment under any of the heads discussed earlier, must be charged to tax as “income from other sources”.
- Section 56(2) specifically provides for the certain items of incomes as being chargeable to tax under the head such as Dividend, Keyman Insurance policy, Winnings from lotteries, Contribution to Provident fund, Income by way of interest on securities, Income from hiring machinery etc, Hiring out of building with machinery, Money Gifts, Share premiums in excess of the fair market value to be treated as income, income by way of interest received on compensation.
- The entire income of winnings, without any expenditure or allowance or deductions under Sections 80C to 80U, will be taxable. **However, expenses relating to the activity of owning and maintaining race horses are allowable.** Further, such income is taxable at a special rate of income-tax i.e., 30% + surcharge + cess @ 3%.
- **Admissible Deductions** : The income chargeable under the head “Income from other sources” is the income after making the deductions such as
 - sum paid by way of commission or remuneration to a banker or any other person for the purpose of realising such interest;
 - deduction shall be allowable in accordance with the provisions of Section 36(1)(va), i.e., if the employer has credited the employee's accounts in the respective funds;
 - a sum equal to 33-1/3% of the income or ₹ 15,000, whichever is less, is allowable as a deduction from family pension;
 - a deduction of a sum equal to 50% of from Interest on compensation or enhanced compensation, and
 - any other expenditure (not being in the nature of capital expenditure) laid out or expended wholly

and exclusively for the purpose of making or earning such income.

- **Inadmissible deductions:** The following amounts shall not be deducted in computing income chargeable under the head 'Income from other sources':
 - Any personal expenses of the assessee.
 - Any interest chargeable under the Income-tax Act which is payable outside India and from which income-tax has not been paid or deducted at source.
 - Any payment which is chargeable under the head "Salaries" if it is payable outside India unless tax has been paid thereon or deducted therefrom at source.
 - Any expenditure referred to in Section 40A of Income-tax Act.
- The basis of charge on income by way of interest on securities is on "receipt" basis if books of account are maintained on cash basis. If the assessee does not maintain books of account or, when he maintains books of account on the basis of "mercantile system", it is taxable on "due" basis.

SELF TEST QUESTIONS

These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation.

MULTIPLE CHOICE QUESTIONS

1. On 30th December, 2013, Raju gets by gift a commercial flat from the elder brother of his father-in-law (stamp duty value is ₹25,00,000). The amount chargeable to tax in the hands of Raju is –
 - (a) ₹ 25,00,000
 - (b) ₹ 24,50,000
 - (c) ₹ 20,00,000
 - (d) Nil.
2. Anu received an aggregate gift of ₹75,000 on 10th August, 2013 from his three friends. The amount chargeable to tax in this case would be –
 - (a) ₹ 50,000
 - (b) ₹ 75,000
 - (c) ₹ 25,000
 - (d) Nothing is taxable.
3. Gift of Rs.4,00,000 received on 10th July 2013 through account payee cheque from a non-resident regularly assessed to Income tax is:
 - (a) A capital receipt not chargeable to tax
 - (b) Chargeable to tax as income from other sources
 - (c) Chargeable to tax as business
 - (d) Exempt upto ₹ 25,000 and balance chargeable to tax as income from other sources.

TRUE AND FALSE

1. Family pension is taxable as income from other sources.
2. Income by way of winnings from lotteries in the hands of a dealer as a regular business activity is not chargeable to tax under the head 'profits and gains of business or profession'.
3. Income from vacant plot of land is taxable under the head 'income from other sources'.

4. Gift from an unrelated person is tax-free upto ₹ 50,000.
5. Marriage gift from a non-relative is not chargeable to tax.

ELABORATIVE

1. Explain the deductions which are available to an assessee under section 57 while computing taxable income chargeable under the head 'income from other sources'.
2. Discuss the cases in which payment by way of loan/advance to the extent of accumulated profits by a closely held company is treated as dividend under section 2(22)(e).
3. What are the incomes chargeable under the head "Income from other sources"?
4. What deductions are allowed under the head "Income from other sources"?
5. What expenses are not allowed to be deducted under the head "Income from other sources"?

PRACTICAL QUESTIONS

1. Discuss the taxability or otherwise of the following gifts received by Madhuri, a lady, during the financial year 2013-14 :
 - (i) ₹ 30,000 from her elder sister.
 - (ii) ₹ 50,000 from the daughter of her elder sister.
 - (iii) Wrist watch valued at ₹ 6,000 from her friend.
2. Adarsh, a Member of Parliament (MP) from Uttar Pradesh, submits the particulars of his income for the assessment year 2014-15. Compute his income from other sources :

	₹
(i) Salary as MP	4,60,000
(ii) Daily allowances as MP	1,80,000
(iii) Dividend received from a domestic company	60,000
(iv) Winnings from horse race (Gross)	40,000
(v) Winnings from Sikkim State lotteries received (Net)	70,000
(vi) Agricultural income in Sri Lanka	4,00,000

He received a royalty of ₹ 1,00,000 from a book of stories written by him. He claimed ₹ 12,000 as expenditure on stationery and typing. He let-out one of his buildings alongwith plant, machinery and furniture for ₹ 50,000 per month. He claimed the following expenses as deduction for this building –

Insurance : ₹10,000; repairs : ₹15,000; depreciation : ₹40,000.

Interest credited to his recurring deposit account and cumulative time deposit account in post office were ₹ 32,000 and ₹ 48,000 respectively.

3. Danny has the following investments in the previous year ended 31st March, 2014:
 - (i) ₹ 7,160 received as interest on securities of Karnataka government.
 - (ii) ₹ 9,000 received as interest on securities of a listed paper manufacturing company.
 - (iii) ₹ 7,200 received as interest on the unlisted securities of a sugar company.
 - (iv) ₹ 30,000, 11% securities (unlisted) of a textile company.

(v) ₹ 20,000, 10% Tamil Nadu government loan.

(vi) ₹ 50,000, 13.5% listed debentures of Dolly Ltd.

Interest on all securities is payable on 30th June, and 31st December. The bank charges 1.5% commission on net realisation of interest as collection charges. Danny also received ₹ 15,000 as director's fee from a company. His other incomes are – winnings from horse race: ₹ 25,000 (gross); and interest on post office savings bank account : ₹ 6,000.

Find out taxable income of Danny from other sources for the assessment year 2014-15.

ANSWERS/HINTS

Multiple Choice Questions

1. (d) ; 2. (b) ; 3. (b)

True and False

1. True ; 2. False ; 3. True ; 4. True; 5. True

Practical Questions

1. (i) Not Taxable ; (ii) Not Taxable ; (iii) Not Taxable ;
2. ₹ 16,55,000, Daily Allowance of MPs are exempt U/s 10(17).
3. ₹ 76,694

SUGGESTED READINGS

- | | |
|--------------------------------|--|
| 1. Dr. V.K. Singhania | : Students Guide to Income-tax; Taxmann Publications Pvt. Ltd.,
New Delhi. |
| 2. Girish Ahuja and Ravi Gupta | : Systematic Approach to Income-tax and Sales-tax; Bharat Law
House, New Delhi. |

Lesson 5

Income of Other Persons Included in Assessee's Total Income and Set-Off or Carry Forward of Losses

LESSON OUTLINE

- Transfer of Income (Section 60)
- Revocable Transfer of Assets (Section 61)
- Transfer irrevocable for a specified period (Section 62)
- Income of Spouse
- Income to son's wife [Section 64(1)(vi)]
- Transfer for immediate or deferred benefit of Son's Wife [Section 64(1)(viii)]
- Income to Spouse through a Third Person [Section 64(1)(vii)]
- Clubbing of income of minor child [Section 64(1A)]
- Income from the converted property [Section 64(2)]
- Set-off and Carry-forward of Losses
- Set-off of losses from one source against income from another source under the same head of income [Section 70]
- Carry forward and set-off of losses
- Carry forward and set-off of accumulated business loss and unabsorbed depreciation in certain cases of amalgamation or demerger etc. (Section 72A)
- Carry forward and set-off of accumulated loss and unabsorbed depreciation allowance in scheme of amalgamation of banking company in certain cases (Section 72AA)
- Treatment of carry-forward of losses of certain assessees
- Lesson Round Up
- Self Test Questions

LEARNING OBJECTIVES

In addition to the general provisions which are applicable for computation of total income, there are special provisions in Sections 60 to 65 of the Income-tax Act which provide for inclusion of income of other persons in the total income of assessee. The special provisions contained in these sections are designed to counteract the various attempts which an individual may make for avoiding or reducing his liability to tax by transferring his assets or income to other person(s) while, at the same time, retaining certain powers or interest over the property or its income. These provisions may also be termed as clubbing provisions.

In the second part of this lesson provisions for set-off and carry forward of losses is being discussed. Sometimes the assessee incurs a loss from a source of income and unless such loss is set-off against any income, the net result of the assessee's activities during the particular accounting year cannot be ascertained and consequently the tax payable would also be incapable of determination. For this purpose, the Income-tax Act contains specific provisions (Sections 70 to 80) for the set-off and carry-forward of losses.

At the end of this lesson, you will learn

- When clubbing provisions are applicable
- What are the provisions of set off/carry forward and set off of losses
- How losses can be set off inter-head and intra-head.
- The conditions to be satisfied for carry forward and set off of loss from house property, business loss and unabsorbed depreciation.
- Up to what period the loss can be carried forward and set-off.

CLUBBING OF INCOME

In addition to the general provisions which are applicable to the assessment of tax-payers and the computation of their total income, there are special provisions in the Income-tax Act which lay down the method of computing the total income of an individual for income-tax purposes. In particular, Sections 60 to 65 of the Income-tax Act provide that in computing the total income of an individual for purposes of assessment, there shall be included all the items of income specified in these sections. The special provisions contained in these sections are designed to counteract the various attempts which an individual may make for avoiding or reducing his liability to tax by transferring his assets or income to other person(s) while, at the same time, retaining certain powers or interest over the property or its income. These provisions are explained below.

TRANSFER OF INCOME (SECTION 60)

Where a person transfers to any other person income (whether revocable or not) from an asset without transferring that asset, the income shall be included in the total income of the transferor. "Transfer" includes any settlement, trust, covenant, agreement or arrangement. The transfer also includes a lease for inadequate consideration and the income derived by the lessee from the leased property is included in the income of the lessor.

If the transferor transfers the asset and keeps the income for himself, the income shall be included in the income of transferor.

Section 60 has no application where assets producing income are transferred along with the income C.I.T. v. Ram Prasad Mehta (1975) 100 ITR 468 (Bombay). There may be a field of operation of Sections 61 to 64 but certainly not of Section 60.

REVOCABLE TRANSFER OF ASSETS (SECTION 61)

Where a person transfers any asset to any other person with a right to revoke the transfer, all income accruing to the transferee from the asset shall be included in the total income of the transferor.

The income under revocable transfer of asset shall be included in the income of transferor even when only a part of income from transferred asset has been applied for the transferor.

For this purpose assets include movable or immovable property whether situated in India or abroad.

As per Section 63, a transfer shall be deemed to be revocable if:

- (i) it contains any provision for the re-transfer directly or indirectly of the whole or any part of the income or assets to the transferor; or
- (ii) it, in any way, gives the transferor a right to reassume power directly, or indirectly over the whole or any part of the income or assets.

Examples of revocable transfers

Some of the examples of revocable transfers are as follows:

- (i) *If there is an express clause of revocation in the instrument of transfer; or*
- (ii) *If there is a sale with a condition of re-purchase; or*
- (iii) *If the transfer is to a trust and if the transfer can be revoked with the consent of two or more beneficiaries; or*
- (iv) *If the trustees are empowered in sole discretion to revoke the transfer; or*
- (v) *If the transferor has power to change beneficiary or trustees.*

However, re-transfer to the transferor must be in the same capacity in which he made the transfer or settlement. If a settlement is made by a Hindu undivided family and there is a re-transfer to one member of the family in his capacity as an individual and not in his capacity as a member of the family this cannot be termed a re-transfer for the purpose.

TRANSFER IRREVOCABLE FOR A SPECIFIED PERIOD (SECTION 62)

If there is an irrevocable transfer of assets for a specified period, the income from such assets shall not be included in the income of transferor provided the following conditions are fulfilled:

- (a) (i) The transfer was made before 1st April, 1961 and **was not revocable for a period exceeding six years; or**
(ii) The transfer is made through a trust and is **not revocable during the life-time of the beneficiary; or**
(iii) The transfer is **not revocable during the life time of the transferee;**

Note, that the exemption ceases as soon as the period for which the asset was transferred expires or the beneficiary or the transferee, as the case may be, die.

- (b) The transferor does not derive any direct or indirect benefit from such assets or income. If the payment reaches back to the transferor through a third party, who receives share from the income or, the settler is fully empowered to take a decision about the investment and can lend to himself without security, it amounts to getting indirect benefit from the income of the trust.
- (c) The transfer is not to or for the benefit of the spouse or minor child (excluding minor married daughter) of the transfer.

INCOME OF SPOUSE

The following incomes of husband and wife are clubbed:

(a) Income to spouse from a concern in which such individual has substantial interest [Section 64(1)(ii)]

All such income as arises directly or indirectly, to the spouse of an individual by way of salary, commission, fees or any other remuneration, whether in cash or kind from a concern in which such individual has a substantial interest, shall be included in the income of the individual. However, where the spouse possesses technical or professional qualifications and the income is solely attributable to the application of his/her technical or professional knowledge and experience, the income shall not be included in the income of (other spouse) the assessee.

An individual shall be deemed to have a **substantial interest** in a concern –

- (i) In a case where the concern is a company, if its shares (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) carrying not less than 20% of the voting power are, at any time during the previous year, owned beneficially by such person or partly by such person and partly by one or more of his relatives;
- (ii) In any other case, if such person is entitled, or such person and one or more of his relatives are entitled in the aggregate, at any time during the previous year, to not less than 20% of the profits of such concern.

Where the individual is not entitled to receive any profit of the concern from which the spouse receives salary, commission, fees or other remuneration, such income shall not be included in the income of such individual and the spouse shall be assessable for this income.

Where both husband and wife have a substantial interest in the concern and both are in receipt of the remuneration in such concern, the remuneration from such concern is to be included in the total income of the husband or, as the case may be, the wife whose total income excluding the income referred to in that clause i.e. 64(1)(ii) is greater; (Circular No. 258, dated 14-6-79) and where any such income is once included in the total income of either spouse, any such income arising in any succeeding year shall not be included in the total income of the other spouse unless the Assessing Officer is satisfied, after giving that spouse an opportunity of being heard, that it is necessary so to do.

Illustration

Mr. P is employed as Public Relation Officer in a company where Mrs. P holds 21 per cent equity shares. She has been holding the share before marriage with

Mr. P., Mr. P gets a salary of ₹ 1,500 per month.

The whole salary of ₹ 18,000 will be included in the income of Mrs. P provided Mr. P has no technical or professional qualification. It is immaterial that the remuneration so paid is genuine and not excessive and that Mrs. P had substantial interest in the company even before her marriage.

(b) Income to spouse from the assets transferred [Section 64(1)(iv)]

Where any individual transfers directly or indirectly any asset (other than a house property) to the spouse, the income from such asset shall be included in the income of the transferor.

In order to attract the provisions of this section, it is not necessary that the asset must have been transferred by the assessee to his spouse in the same form in which it stands at the time the income arises. Conversion of assets from one form to another would be totally immaterial and it is also not essential that the transfer must have taken place directly between the spouses. However, there are exceptions to this rule:

- (i) The transferor has received adequate consideration in money or money's worth. If the consideration was inadequate, proportionate income shall be included in the income of the transferor.
- (ii) The transfer has been made in connection with an agreement to live apart. This separation can be either judicial or voluntary under circumstances in which a judicial separation can be granted.
- (iii) The income from the assets transferred shall not be included in the income of transferor after the death of spouse, either transferor or transferee.
- (iv) The income from assets transferred shall be included in the income of the transferor, only if the relationship as spouse exists on the two dates, i.e., the date of transfer and the date on which the income accrues or arises to the transferee. If any asset has been transferred before marriage, the income from such asset cannot be included in the income of the transferor.
- (v) Only the direct income (including capital gains) earned with the help of the transferred assets shall be included in the income of the transferor. Any indirect income to the transferee from the transferred assets shall not be included in the income of the transferor.

Suppose, A transfers certain shares to his wife B. Dividends received on such shares are taxable to A. If B sells the shares and makes some capital gains, such gains are also taxable in A's hands. Now from the dividend money, B purchases some more shares and receives dividends on these new shares, such dividends are not taxable to A. In the same way, if B receives certain bonus shares on the shares transferred by her husband and later on she receives dividend on such bonus shares, the dividend shall not be included in the income of the transferor because the bonus shares were never transferred by her husband.

If some pin-money is given to wife by her husband neither the savings out of pin-money nor the income earned with the help of savings out of pin-money can be included in the income of husband.

INCOME TO SON'S WIFE [SECTION 64(1)(vi)]

Where any individual transfers, directly or indirectly, any asset to his/her son's wife without adequate consideration, after 1.6.1973, the income from such asset shall be included in the income of the transferor.

TRANSFER FOR IMMEDIATE OR DEFERRED BENEFIT OF SON'S WIFE [SECTION 64(1)(viii)]

Any income arising, directly or indirectly, to any person or association of persons from assets transferred directly or indirectly after June 1, 1973, otherwise than for adequate consideration to the person or association of persons by such individual shall, to the extent to which the income from such assets is for the immediate or deferred benefit of his son's wife be included in computing the total income of such individual.

Explanation: For the purpose of clauses (iv) and (vi), where the assets transferred directly or indirectly by an individual to his spouse or son's wife (hereafter in this Explanation referred to as "the transferee") are invested by the transferee –

- (i) in any business, such investment being not in the nature of contribution of capital as a partner in a firm or, as the case may be, for being admitted to the benefits of partnership in a firm, that part of the income arising out of the business to the transferee in any previous year, which bears the same proportion to the income of the transferee from the business as the value of the assets aforesaid as on the first day of the previous year bears to the total investment in the business by the transferee as on the said day;
- (ii) in the nature of contribution of capital as a partner in a firm, that part of the interest receivable by the transferee from the firm in any previous year, which bears the same proportion to the interest receivable by the transferee from the firm as the value of investment aforesaid as on the first day of the previous year bears to the total investment by way of capital contribution as a partner in the firm as on the said day,

shall be included in the total income of the individual in that previous year.

INCOME TO SPOUSE THROUGH A THIRD PERSON [SECTION 64(1)(vii)]

Where a person transfers some assets directly or indirectly to a person or association of persons (trustee or body of trustees or juristic person) without adequate consideration for the immediate or deferred benefit of his or her spouse, all such income as arises directly or indirectly from assets transferred shall be included in the income of the transferor. If only a portion is reserved for the benefit of spouse and a portion is utilised for the benefit of others, only the portion reserved for the spouse shall be included in the income of the transferor.

The share of income of the spouse can be included in the income of the transferor provided the spouse has either received the income or the income has accrued to spouse or the spouse has a beneficial interest in the income. If an individual creates a life-interest in a property in favour of a third person and grants the remainder to his spouse, and so long as the third person is alive, she should not be getting any benefit out of transferred asset, such income cannot be included in the income of the transferor. If however, the benefit from the assets transferred is to be derived by the transferor himself, the transfer would be treated as revocable and would consequently fall within the purview of Section 61 which provides that the entire income arising from the assets so transferred shall be included in the total income of the transferor.

Where a trust was created by assessee's mother for the benefit of the assessee, his wife and the trustees were authorised to carry on business, the income from the business was held to be income of the trust and the share of wife could not be added to the income of the spouse because neither the trust was created by the assessee nor the business done in the partnership. [K.T. Doctor v. C.I.T. (1980) 124 ITR 501 (Guj.)].

CLUBBING OF INCOME OF MINOR CHILD [SECTION 64(1A)]

All income which arises or accrues to the minor child (not being a minor child suffering from any disability of the

nature specified in Section 80U) shall be clubbed in the income of his parent. However, any income which is derived by the minor from manual work or from any activity involving application of his skill, talent or specialised knowledge and experience will not be included in the income of his parent. Further, the income of the minor shall be included in the income of that parent whose total income excluding income includable under this sub-section is greater, where the marriage of minor's parents subsists, otherwise the income of the minor will be includable in the income of that parent who maintains the minor child in the relevant previous year.

Once the income of the minor is included in the total income of any one parent, clubbing of income of the minor with the same parent will continue in subsequent years also, unless the Assessing Officer is satisfied, after giving that parent an opportunity of being heard that it is necessary so to do.

In case the income of an individual includes any income of his minor child in terms of this section [i.e. Section 64(1A)], such individual shall be entitled to exemption of the amount of such income or Rs. 1,500 whichever is less.

INCOME FROM THE CONVERTED PROPERTY [SECTION 64(2)]

Where an individual, being a member of Hindu Undivided Family, transfers his self-acquired property after 31st December, 1969 to the family for the common benefit of the family, or throwing it into the common stock of the family, or transfers it directly or indirectly to the family otherwise than for adequate consideration, such property is known as converted property. The income derived from the converted property or any part thereof, shall be included in the income of the transferor.

For this section "property" includes any interest in property, movable or immovable the proceeds of sale thereof and any money or investment for the time being representing the proceeds of sale thereof and where the property is converted into any other property by any method, such other property.

Income from converted property to spouse after partition

Where the converted property has been the subject matter of total or partial partition amongst the members of the family, the income derived from such converted property as is received by the spouse of the transferor on partition shall be included in the income of the individual.

The income so included in the total income of the individual shall be excluded from the total income of the family or spouse, as the case may be.

The income from the above mentioned items shall first be computed under the appropriate heads in the hands of the transferee and after that it shall be included in the total income of the transferor under the head, "Income from other sources". However, the income from house property transferred to spouse shall be computed under the head 'Income from house property' in the hands of transferor and not in the hands of the transferee.

An explanation was added by the Finance Act, 1979 w.e.f. 1.4.80 to provide that the term 'income' used in Section 64 includes 'loss'. This amendment nullifies the decision in *Dayalbhai Madhavji Vadera v. C.I.T.* (1966) 60 ITR 551 of the Gujarat High Court that the term 'income' used in Sub-section (1) of Section 64 does not include a loss.

RECOVERY OF TAX

Dual Liability for Tax: The tax on the income of the other person which has been included in the income of the assessee can either be recovered from the assessee or from the other person. The liability of other person is limited to the portion of the tax levied on the assessee which is attributable to the income so included. His liability arises after the service of a notice of demand by the Assessing Officer in this behalf.

Where any such asset (the income from which has been included in that of the assessee) is held jointly by more than one person, they shall be jointly and severally liable to pay the tax which is attributable to the income from the assets so included.

Illustration

Green holds 25% shares in Blue Ltd. along with his relatives. Blue Ltd. has employed Mrs. Green at a salary of ₹ 50,000 per month. She does not hold any technical or professional qualification.

Other incomes of Green are as follows :

- Business : ₹ 4,50,000
- Dividend from Blue Ltd. : ₹ 1,80,000

Other income of Mrs. Green is income from house property (net of deduction under section 24) of ₹ 1,20,000.

Compute taxable income and tax liability of Green and Mrs. Green for Assessment Year 2014-15.

Solution

In the present case, Mrs. Green's salary income would be clubbed in the hands of Mr. Green as Income from salary as he holds substantial interest (i.e. 20% or more shares) in Blue Ltd. along with his relatives and salary is provided by Blue Ltd. to Mrs. Green without any technical / professional qualification.

Computation of Total Income and Tax liability of Green and Mrs. Green

Particulars	Green (₹)	Mrs. Green (₹)
Income from Salary [Clubbed in the hands of Green] (50,000 x 12)	6,00,000	Nil
Income from house property	Nil	1,20,000
Business Income	4,50,000	Nil
Dividend Income [Exempt u/s 10(34)]	Nil	1,20,000
Gross Total Income (or Total Income)	10,50,500	1,20,000
<i>Tax Liability: Tax on Total Income</i> [(10,50,000 – 10,00,000)] x 30% + 1,30,000	1,45,000	Nil
<i>Add: Cess @ 3%</i>	4,350	Nil
Tax Payable	1,49,350	Nil

Illustration

Red holds 40% of shares in a Company. Mrs. Red (a CS) is employed in the company as a Company Secretary and is getting salary of ₹ 15,000 per month. Compute total income and tax payable by Red and Mrs. Red for the Assessment Year 2014-15 assuming other income of Red is ₹ 2,00,000 from a business and dividend income from company is ₹ 3,00,000.

Solution

In the present case, Mrs. Red's salary income will be taxable in her hands only as she is earning the same through her professional qualification.

Computation of Total Income and Tax Liability for Assessment Year 2014-15

Particulars	Red (₹)	Mrs. Red (₹)
Income from Salary	Nil	1,80,000
Business Income	2,00,000	Nil
<i>Income from other sources: Dividend Income [Exempt u/s 10(34)]</i>	Nil	Nil
Gross Total Income (or Total Income)	2,00,000	1,80,000
<i>Tax Liability (as total income does not exceed ₹ 2,00,000):</i>	Nil	Nil

PART-II

SET-OFF AND CARRY-FORWARD OF LOSSES

Income-tax is levied on the total income of the previous year of an assessee. Hence, it is necessary to ascertain the total income. Sometimes the assessee incurs a loss from a source of income and unless such loss is set-off against any income, the net result of the assessee's activities during the particular accounting year cannot be ascertained and consequently the tax payable would also be incapable of determination. For this purpose, the Income-tax Act contains specific provisions (Sections 70 to 80) for the set-off and carry-forward of losses.

SET-OFF OF LOSSES FROM ONE SOURCE AGAINST INCOME FROM ANOTHER SOURCE UNDER THE SAME HEAD OF INCOME [SECTION 70]

If the net result for any assessment year in respect of any source falling under any head of income is a loss, the assessee is entitled to set off the amount of such loss against his income from any other source under the same head.

Exception to the General Rule: However, the following are the exceptions to general rule:

- (i) **Loss from Speculation Business:** Income from speculation business is computed under the head income from business or profession. But if there is any loss from speculation business, it cannot be set-off against the income from other business or profession. It can be set-off only against the profit in a speculation business. However, the loss of non-speculation business can be set-off against the income from speculation business.
- (ii) **Loss from the activity of owning and maintaining race horses:** Loss incurred in the business of owning and maintaining race horses cannot be set off against any income except income from such business. However, loss from any activity other than the business of owning and maintaining race horses can be set off against income from the business of owning and maintaining race horses.
- (iii) W.e.f. Assessment Year 2003-04 short term capital loss can be set off from any capital gain (long-term or short-term). But long-term capital loss can be set off only against long-term capital gain.

(A) Loss from business or profession

Any loss from business or profession (other than speculation business or loss from the activity of owning and maintaining race horses) can be set off against the income from any other business or profession including the income from speculation business or income from the activity of owning and maintaining race horses.

If any business has been discontinued during the year, the loss from such business can also be set-off from the income of other business or profession.

The loss suffered by a wholly owned subsidiary company cannot be set-off by the parent company, since both are separate assessees. Similarly, where loss incurred by a wholly owned subsidiary company is reimbursed by the holding company, the subsidiary company does not use the right to carry forward and set-off the loss. [C.I.T. v. Handicraft Handloom Export Corporation (1982) 133 ITR 590 (Delhi)].

(B) Loss from speculation business

Such loss can be set-off only against the income from speculation business. It is not essential that the nature of the other speculation transaction must be the same. Speculative transactions in different commodities and in different markets are to be treated as one business. However, a loss from an illegal speculation business cannot be set-off against income from any lawful speculation. [C.I.T. v. K.J. Kotecha 107 ITR 101 (SC)]. Similarly, where the assessee earns commission on speculative transactions, he is not entitled to set-off speculative loss against such commission because there is no element of speculation in the commission [C.I.T. v. Pangal Vittal Nayak &

Co. Pvt. Ltd. (1969) 74 I.T.R. 754 (S.C.)]. By virtue of an explanation to Section 73 where any part of the business of a company (other than a company whose gross total income consists mainly of income which is chargeable under the heads: "Interest on securities", "Income from House Property", "Capital gains", "Income from other sources", or a company the principal business of which is the business of banking or granting of loans and advances) consists of the purchase and sale of shares of other companies, such company shall for the purpose of this section (Section 73), be deemed to be carrying on a speculation business to the extent to which the business consists of the purchase and sale of such shares.

(C) Set-off of loss from one head against income from another head [Section 71]

The provision of Section 71 reads as under:

- (a) an assessee not having any income under the head "Capital gains" and having loss from income under other heads (excluding capital gains) can set off such loss against his income under any other head (other than "capital gains");
- (b) loss under any head of income (other than "capital gains") can be set off against income from any head of income, including "capital gains";
- (c) loss under the head "capital gains" cannot be set off against income under any other head. It must be set off only against income from "capital gains".

(D) Set-off of losses under the head 'income from house property'

Where the assessee incurs any loss under the head income from house property it can be set off against the assessee's any other income under other head during the previous years where such loss is not fully adjusted under other heads of income in the same assessment year, then the balance loss shall be allowed to be carried forward and set off in subsequent years subject to a limit of eight assessment years against income from house property.

(E) Loss from a source which is exempt

Loss incurred by an assessee from a source, income from which is exempt, cannot be set-off against income from a taxable source.

CARRY-FORWARD AND SET-OFF OF LOSSES

If it is not possible to set-off the losses during the same assessment year in which these occurred, so much of the loss as has not been so set-off out of the following losses, can be carried forward to the following assessment year and so on to be set-off against the income of those years provided the losses have been determined in pursuance of a return filed by the assessee and it is the same assessee who sustained the loss.

- (i) Loss in non-speculation business or profession.
- (ii) Loss in speculation business.
- (iii) Loss in transfer of capital assets [whether short-term or long-term].
- (iv) Loss from activity of owning and maintaining of race horses.
- (v) Loss under the head 'Income from House Property' so far as it relates to interest on borrowed capital referred to in Section 24(1)(vi). It is applicable up to assessment year 1996-97 only.

However, losses suffered under the following heads are not allowed to be carried forward and set off:

- (1) *Losses under the head 'salaries'.*
- (2) *Losses under the head 'Income from other sources'*
(excepting loss suffered from the activity of owning and maintaining race horses).

(A) Loss in non-speculation business

It shall be set-off against the profits and gains, if any, of any business or profession carried on by him and assessable for that assessment year.

From this it follows that the loss from non-speculation business or profession can be set-off against the income of the business in which it was suffered or any other business or profession either old or new including speculation business income or from any other head, such as house property, or other sources, if the income under this head forms part of the trading activities of the assessee. [*Western States Trading Co. (P) Ltd. v. C.I.T. (1971) 80 ITR 21 (SC)*].

The loss can be set-off against the business profits of the year provided such profits are assessable to tax. If the profits are exempt from tax for any reason, no set-off can be made by the income-tax officer against such profits.

Conditions for carry forward and set-off of business loss

- (i) The right of carry-forward and set-off is available to the same assessee who has sustained the loss. A holding company however, cannot claim to carry forward the losses, if any, incurred by its wholly owned subsidiary company. Exceptions to this rule are (a) cases of succession by inheritance [a loss incurred by the father in the course of carrying on his business can be carried forward and set-off by his son, if the son succeeds to the business of his father on account of the father's death but not otherwise] (b) accumulated business loss of an amalgamating company under Section 72A (c) the share of loss of partnership taken over by one of its partners can also be set-off by the partner [*Dwarkadass Leeladhar v. CIT (1963) 47 ITR 619 (Ker.)*]

However, loss incurred by HUF cannot be carried forward and set-off after its partition against income of firm formed thereafter by certain coparceners [*Keshrichand Bhanabhai v. CIT (1951) 20 ITR 201 (Bom.)*].

- (ii) The loss can be carried forward to a maximum of eight consecutive assessment years immediately succeeding the assessment year for which the loss was first computed.

In case of a business on which rehabilitation allowance has been allowed, the previous losses are allowed to be carried forward to the assessment year relevant to the previous year in which the business was so revived or re-established and are allowed to be set-off against the profits of that assessment year. Any balance of loss can be carried forward to the succeeding seven assessment years.

- (iv) Where any unabsorbed depreciation or capital expenditure on scientific research has been brought forward alongwith business loss, the business loss shall first be set-off.

In case where profits are insufficient to absorb brought forward losses, current depreciation and current business losses, the same should be deducted in the following order:

- (a) *Current scientific research expenditure [under Section 35(1)].*
- (b) *Current Depreciation [under Section 32(1)].*
- (c) *Brought forward business losses [under Section 72(1)].*
- (d) *Unabsorbed family planning promotion capital expenditure [under Section 36(1)(ix)].*
- (e) *Unabsorbed Depreciation [under Section 32(2)].*
- (f) *Unabsorbed scientific research expenditure [under Section 35(4)].*

CARRY FORWARD AND SET-OFF OF ACCUMULATED BUSINESS LOSS AND UNABSORBED DEPRECIATION IN CERTAIN CASES OF AMALGAMATION OR DEMERGER ETC.(SECTION 72A)

W.e.f. assessment year 2000-2001, Section 72A has been substituted by new section to provide for carry forward and set off of accumulated loss and unabsorbed depreciation allowance in case of:

- (i) amalgamation [Section 72A(1), (2) and (3)], or
- (ii) demerger [Section 72A(4) and (5)], or
- (iii) reorganisation of business [Section 72A(6)].

(i) Carry forward and set off of accumulated loss and unabsorbed depreciation in case of amalgamation [Section 72A(1), (2) and (3)]

(1) Where there has been an amalgamation of a company owning an industrial undertaking or a ship or a hotel with another company or an amalgamation of a banking company referred to in Clause (c) of Section 5 of the Banking Regulation Act, 1949 (10 of 1949) with a specified bank, then, notwithstanding anything contained in any other provision of this Act, the accumulated loss and the unabsorbed depreciation of the amalgamating company shall be deemed to be the loss or, as the case may be, allowance for depreciation of the amalgamated company for the previous year in which the amalgamation was effected, and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly.

(2) Notwithstanding anything contained in Sub-section (1), the accumulated loss shall not be set off or carried forward and the unabsorbed depreciation shall not be allowed in the assessment of the amalgamated company unless –

- (a) the amalgamating company –
 - (i) has been engaged in the business, in which the accumulated loss occurred or depreciation remains unabsorbed, for three or more years;
 - (ii) has held continuously as on the date of the amalgamation at least three-fourths of the book value of fixed assets held by it two years prior to the date of amalgamation;
- (b) the amalgamated company –
 - (i) holds continuously for a minimum period of five years from the date of amalgamation at least three-fourths of the book value of fixed assets of the amalgamating company acquired in a scheme of amalgamation;
 - (ii) continues the business of the amalgamating company for a minimum period of five years from the date of amalgamation;
 - (iii) fulfils such other conditions as may be prescribed to ensure the revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purpose.

Consequences if the above conditions are not satisfied [Section 72A(3)]: In a case where the conditions laid down under Clause (b) above are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the amalgamated company shall be deemed to be in the income of the amalgamated company chargeable to tax for the year in which such conditions are not complied with.

[Note: The carry forward and set off of loss and unabsorbed depreciation as per the above provisions shall be allowed only when amalgamation is as per the provisions of Section 2(1B) of the Income-tax Act, 1961].

(ii) Carry forward and set off of accumulated losses and unabsorbed depreciation in case of demerger [Sections 72A(4) and (5)]

Notwithstanding anything contained in any other provisions of this Act in the case of a demerger, the accumulated loss and the allowance for absorbed depreciation of the demerged company shall –

- (a) where such loss or unabsorbed depreciation is directly relatable to the undertakings transferred to the resulting company, be allowed to be carried forward and set off in the hands of the resulting company;

- (b) where such loss or unabsorbed depreciation is not directly relatable to the undertakings transferred to the resulting company, be apportioned between the demerged company and the resulting company in the same proportion in which the assets of the undertakings have been retained by the demerged company and transferred to the resulting company, and be allowed to be carried forward and set off transferred to the resulting company, and be allowed to be carried forward and set off in the hands of the demerged company or the resulting company, as the case may be.

The Central Government may, for the purposes of this Act, by notification in the Official Gazette, specify such conditions as it considers necessary to ensure that the demerger is for genuine business purposes.

[**Note:** The carry forward and set off of accumulated loss and unabsorbed depreciation as per the above provisions shall be allowed only when demerger is as per the provisions of Section 2(19AA) of the Income-tax Act.]

(iii) Carry forward and set off of accumulated losses and unabsorbed depreciation in case of reorganisation of business [Section 72A(6)]

Where there has been reorganisation of business, whereby, a firm is succeeded by a company fulfilling the conditions laid down in Clause (xiii) of Section 47 or a proprietary concern is succeeded by a company fulfilling the conditions laid down in Clause (xiv) of Section 47, then, notwithstanding anything contained in any other provisions of this Act, the accumulated loss and the unabsorbed depreciation of the predecessor firm or the proprietary concern, as the case may be, shall be deemed to be the loss or allowance for depreciation of the successor company for the purpose of previous year in which business reorganisation was effected and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly.

Section 72(6A): Where there has been reorganisation of business whereby a private company or unlisted public company is succeeded by a limited liability partnership fulfilling the conditions laid down in the proviso to clause (xiib) of section 47, then, notwithstanding anything contained in any other provision of this Act, the accumulated loss and the unabsorbed depreciation of the predecessor company, shall be deemed to be the loss or allowance for depreciation of the successor limited liability partnership for the purpose of the previous year in which business reorganisation was effected and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly.

Consequences if the conditions laid down under Section 47(xiii),(xiv) and 47(xiib) are not complied with [Proviso to Section 72A(6) & (6A)]

If any of the conditions laid down under Section 47(xiii) and (xiv) are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the successor company, shall be deemed to be the income of the company chargeable to tax in the year in which such conditions are not complied with.

If any of the conditions laid down in the proviso to clause (xiib) of section 47 are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the successor limited liability partnership, shall be deemed to be the income of the limited liability partnership chargeable to tax in the year in which such conditions are not complied with.

Note: “**Accumulated loss**” means so much of the loss of the predecessor firm or the proprietary concern or the private company or unlisted public company before conversion into limited liability partnership or the amalgamating company or the demerged company, as the case may be, under the head “Profits and gains of business or profession” (not being a loss sustained in a speculation business) which such predecessor firm or the proprietary concern or the company or amalgamating company or demerged company, would have been entitled to carry forward and set off under the provisions of section 72 if the reorganisation of business or conversion or amalgamation or demerger had not taken place;

“**Unabsorbed depreciation**” means so much of the allowance for depreciation of the predecessor firm or the

proprietary concern or the private company or unlisted public company before conversion into limited liability partnership or the amalgamating company or the demerged company, as the case may be, which remains to be allowed and which would have been allowed to the predecessor firm or the proprietary concern or the company or amalgamating company or demerged company, as the case may be, under the provisions of this Act, if the reorganisation of business or conversion or amalgamation or demerger had not taken place.

(B) Loss in speculation business [Section 73]

Where, for any assessment year, any loss computed in respect of a speculation business has not been wholly set-off against the profits of another speculation business, it shall be carried forward to the following assessment year and shall be set-off against the profits of any speculation business carried on by him and assessable for the assessment year.

In case of speculation loss even if the particular speculation business in which there is loss is discontinued, this loss can be carried forward to be set-off in the succeeding year against the profits of any other speculation business.

This loss can be carried forward to a maximum of four consecutive assessment years immediately succeeding the assessment year for which the loss was first computed.

However, the loss from an illegal speculation business or loss incurred in speculation business in banned items can be neither set-off against income from any lawful speculation business nor can it be carried forward for being set-off in the subsequent year against income even from an illegal speculation business because the law assumes that any illegal business dies with all its losses in the same year [*CIT v. Kurji Jinabhai Koticha (1977) 107 ITR 101 (SC)*].

Where any unabsorbed depreciation or capital expenditure on scientific research has been brought forward along with speculation loss, the speculation loss shall first be set-off.

Sometimes there may be brought-forward speculation loss and current year's non-speculation business loss. Now the problem arises whether the brought forward speculation loss should be adjusted first against the current year's speculation income or current year's non-speculative business loss should be set-off first against the current year's speculative income. Accordingly to the administrative instructions the Assessing Officer may allow the assessee:

- (i) either to first set-off the speculation loss carried forward from an earlier year against the speculation profits of the current year and then to set-off the current year's losses against other sources and against the remaining part, if any, of the current year's speculation profits; or
- (ii) to first set-off the current year's losses from non-speculation business and other sources against the current year's speculation profits and then to set-off the carried forward speculation losses of the earlier year against the remaining part, if any, of the current year's speculation profits, whichever is advantageous to the assessee.

Where an assessee has brought forward speculative loss from his individual business and during the current year he receives some speculative gains from a firm in which he is a partner, the brought forward loss can be set-off against the speculative profits received from the firm. Similarly, where a speculation business is carried on by sole proprietor and after his death the business is continued by legal heirs forming partnership, the firm is entitled to carry forward and set-off such loss. [*C.I.T. v. Madhukant M. Mehta (1981) 132 ITR 159 (Guj.)*].

(C) Carry forward and set off of losses by specified business (Section 73A)

- (1) Any loss of any specified business in section 35AD shall not be set off except against profits and gains of any other specified business.
- (2) Where for any assessment year any loss computed of the specified business has not been wholly set off, the

loss not set off shall be carried forward to the following assessment year, and

- (i) it shall be set off against the profits and gains of any specified business carried on by him and
- (ii) if the loss can not be wholly set off, the amount of loss not set off shall be carried forward to the following assessment year and so on..

(D) Set-off and carry forward of capital losses [Section 74]

- (i) Where, in respect of any assessment year, the net result of the computation under the head "Capital gains" is a loss to the assessee, it can be carried forward to the following assessment year. The short-term and long-term losses shall be separately carried forward. In case of short-term capital loss it can be set off against income, if any, under the head "Capital gains" (whether short-term or long-term) assessable for that assessment year in respect of any other capital asset. But in case of long-term capital loss, it can be set off only against long-term capital gain.
- (ii) While losses on transfer of capital assets, whether short-term or long-term cannot be set off against any other income of the assessee under other heads of income i.e. heads other than 'capital gains' in the previous year in which such loss was incurred, it can be carried forward to be set off against capital gains if any during the next eight assessment years.

(E) Loss on maintenance of race horses

Where an assessee who is the owner of race horses sustains a loss in the activity of owning and maintaining race horses, he can carry-forward and set-off such loss against his income (Prize money received on a race horse or race horses) from the activity of owning and maintaining race horses in subsequent years. This loss can be carried forward to a maximum of four assessment years immediately succeeding the assessment year for which the loss was first computed.

(F) Loss under the head "Income from other sources"

Except the loss from the activity of owning and maintaining of race horses, the unabsorbed loss from no other activity under the above head is permitted to be carried forward and set off against income of subsequent years.

CARRY FORWARD AND SET OFF OF ACCUMULATED LOSS AND UNABSORBED DEPRECIATION ALLOWANCE IN SCHEME OF AMALGAMATION OF BANKING COMPANY IN CERTAIN CASES (SECTION 72AA)

Section 72AA inserted by the Finance Act, 2005 provides for carry forward and set off of accumulated loss and unabsorbed depreciation allowance in scheme of amalgamation of banking companies.

Where there has been an amalgamation of a banking company with any other banking institution under a scheme sanctioned and brought into force by the Central Government under Sub-section (7) of Section 45 of the Banking Regulation Act, 1949, the accumulated loss and the unabsorbed depreciation of such banking company shall be deemed to be the loss or, as the case may be, allowance for depreciation of such banking institution for the previous year in which the scheme of amalgamation was brought into force and other provisions of this Act relating to set-off and carry forward of loss and allowance for depreciation shall apply accordingly.

The terms, "accumulated loss", "banking company", "banking institution" and "unabsorbed depreciation" for the purposes of this Section are defined as under:

- (i) **"accumulated loss"** means so much of the loss of the amalgamating banking company under the head "Profits and gains of business or profession" (not being a loss sustained in a speculation business) which such amalgamating banking company, would have been entitled to carry forward and set-off under the provisions of Section 72, if the amalgamation had not taken place.
- (ii) **"banking company"** shall have the same meaning assigned to it in Clause (c) of Section 5 of the Banking Regulation Act, 1949 (10 of 1949);

- (iii) "**banking institution**" shall have the same meaning assigned to it in Sub-section (15) of Section 45 of the Banking Regulation Act, 1949 (10 of 1949);
- (iv) "**unabsorbed depreciation**" means so much of the allowance for depreciation of the amalgamating banking company which remains to be allowed and which would have been allowed to such banking company if amalgamation had not taken place.

TREATMENT OF CARRY-FORWARD OF LOSSES OF CERTAIN ASSESSEES

(1) **Carry-forward and set-off of losses in case of change in constitution of firm (Section 78)**

Where a change has occurred in the constitution of a firm, the firm is not entitled to carry forward and set off so much of the loss proportionate to the share of a retired or deceased partner as exceeds his share of profits, if any, in the firm in respect of the previous year.

(2) **Carry-forward and set-off of losses in case of succession of business or profession**

When a business or profession is succeeded by another person, the brought forward losses by the predecessor can be set-off against the income earned by the predecessor before the succession. The successor is not entitled to carry forward the losses sustained by the predecessor and set them off against the income earned by him. However, there is exception. If the succession is by inheritance, the heir-at-law is entitled to carry-forward and set-off the losses sustained by the predecessor provided the business in question continues to be carried on by the successor.

(3) **Carry-forward and set-off of losses of companies in which the public are not substantially interested (Section 79)**

The losses of companies in which the public are not substantially interested can be carried forward and set-off only if the following condition is satisfied:

- (a) The shares of the company carrying not less than 51 per cent of the voting power were beneficially held by the same persons on the last day of the year or years in which the loss was incurred and also on the last day of the previous year in which the brought forward loss is to be adjusted. Where a change in voting power of more than 51 per cent of share holding has occurred between the two dates mentioned above (i.e. last day of the year of occurrence of loss and the last day of the previous year in which the brought forward loss is to be adjusted), the assessee will not be entitled to the benefit of set-off.

However, the benefit of set-off will not be denied if the change in voting power is due to the death of a shareholder or on account of transfer of shares by way of gift to any relative of the shareholder making such gift.

The effect of this provision is that if the majority of the voting power is not in the same hands both on the last day of the previous year in which the loss was sustained by the closely-held company and on the last day of the previous year in which the set off is claimed, set off will not be allowed under Section 72. This is obviously to frustrate attempts at trafficking in losses.

It has been further provided by Finance Act, 1999 w.e.f. 1.4.2000 that benefit of set off will also not be denied in the case where any change in the shareholding of an Indian company which is a subsidiary of a foreign company as a result of amalgamation or demerger of a foreign company subject to the condition that fifty one per cent shareholders of the amalgamating or demerged foreign company continue.

SUBMISSION OF RETURN FOR LOSS (SECTION 80)

An assessee is not entitled to carry-forward a loss unless he has filed a return of loss to the Department in time and in the prescribed form. It is obligatory on the part of the assessee to file such return, otherwise he will be deprived of the benefit of carry-forward of losses. In fact, only that amount of loss is allowed to be carried-forward which has been computed by the Assessing Officer and not by the assessee.

Summary of provisions regarding carry forward and set-off of losses

SET-OFF OF LOSSES (Sec. 70, 71)

Loss	Set-Off
1. Loss from house property.	(a) Income from any other house property (b) Any other head of income
2. Loss from business or profession	(a) Income from any other business or Profession. (b) Any other head of income except under the head "Salaries"
3. Loss from speculation	(a) Income from speculation
4. Short-term capital loss	(a) Short-term capital gain (b) Long-term capital gain
5. Long-term capital loss	(a) Long-term capital gain
6. Loss from activity of owning and maintaining race horses	(a) Income from activity of owing and maintaining race horses.

CARRY FORWARD AND SET-OFF OF LOSSES (Sec. 72)

Loss	Set-Off
1. Loss from house property.	In following eight years, income from house property.
2. Loss from business or profession	In following eight years, income from business or profession.
3. Loss from speculation	In following four years (w.e.f. A.Y. 2006-07), income from speculation.
4. Short-term capital loss	In following eight years : (a) Short-term capital gain (b) Long-term capital gain
5. Long-term capital loss	In following eight years, Long-term capital gain.
6. Loss from activity of owning and maintaining race horses	In following four years, Income from activity of owing and maintaining race horses

LESSON ROUND UP

- Sections 60 to 65 of the Income-tax Act provide that in computing the total income of an individual for purposes of assessment, there shall be included all the items of income specified in these sections.
- **Transfer of Income (section 60) :** Where a person transfers to any other person income (whether revocable or not) from an asset without transferring that asset, the income shall be included in the total income of the transferor. "Transfer" includes any settlement, trust, covenant, agreement or arrangement.
- **Revocable transfer:** Where a person transfers any asset to any other person with a right to revoke the transfer, all income accruing to the transferee from the asset shall be included in the total income of the transferor.

- The income under revocable transfer of asset shall be included in the income of transferor even when only a part of income from transferred asset has been applied for the transferor.
- **Irrevocable Transfer:** In case of an irrevocable transfer of assets for a specified period, the income from such assets shall not be included in the income of transferor.
- **Income to spouse from a concern in which such individual has substantial interest [Section 64(1)(ii)]:** All such income as arises directly or indirectly, to the spouse of an individual by way of salary, commission, fees or any other remuneration, whether in cash or kind from a concern in which such individual has a substantial interest, shall be included in the income of the individual.
- **Income to spouse from the assets transferred [Section 64(1)(iv)]:** Where any individual transfers directly or indirectly any asset (other than a house property) to the spouse, the income from such asset shall be included in the income of the transferor.
- **Income To Son's Wife [Section 64(1)(vi)]:** Where any individual transfers, directly or indirectly, any asset to his/her son's wife without adequate consideration, after 1.6.1973, the income from such asset shall be included in the income of the transferor.
- **Transfer for Immediate or Deferred Benefit of Son's Wife [Section 64(1)(viii)]:** Any income arising, directly or indirectly, to any person or association of persons from assets transferred directly or indirectly after June 1, 1973, otherwise than for adequate consideration to the person or association of persons by such individual shall, to the extent to which the income from such assets is for the immediate or deferred benefit of his son's wife be included in computing the total income of such individual.
- **Income to spouse through a third person [Section 64(1)(Vii)]:** Where a person transfers some assets directly or indirectly to a person or association of persons (trustee or body of trustees or juristic person) without adequate consideration for the immediate or deferred benefit of his or her spouse, all such income as arises directly or indirectly from assets transferred shall be included in the income of the transferor.
- **Clubbing of Income Of Minor Child [Section 64(1a)]:** All income which arises or accrues to the minor child (not being a minor child suffering from any disability of the nature specified in Section 80U) shall be clubbed in the income of his parent. However, any income which is derived by the minor from manual work or from any activity involving application of his skill, talent or specialised knowledge and experience will not be included in the income of his parent.

In case the income of an individual includes any income of his minor child in terms of this section [i.e. Section 64(1A)], such individual shall be entitled **to exemption of the amount of such income or Rs. 1,500 whichever is less.**

- **Income From The Converted Property [Section 64(2)]:** Where an individual, being a member of Hindu Undivided Family, transfers his self-acquired property after 31st December, 1969 to the family for the common benefit of the family, or throwing it into the common stock of the family, or transfers it directly or indirectly to the family otherwise than for adequate consideration, such property is known as converted property.
- **Dual Liability for Tax:** The tax on the income of the other person which has been included in the income of the assessee can either be recovered from the assessee or from the other person. The liability of other person is limited to the portion of the tax levied on the assessee which is attributable to the income so included.
- **Set Off - carry Forward of losses:** Sometimes the assessee incurs a loss from a source of income and unless such loss is set-off against any income, the net result of the assessee's activities during

the particular accounting year cannot be ascertained and consequently the tax payable would also be incapable of determination. For this purpose, the Income-tax Act contains specific provisions (Sections 70 to 80) for the set-off and carry-forward of losses.

- **Set-Off of Losses from one source against Income from another source under the same Head of Income [Section 70]:** If the net result for any assessment year in respect of any source falling under any head of income is a loss, the assessee is entitled to set off the amount of such loss against his income from any other source under the same head. However, Loss from Speculation Business, Loss from the activity of owning and maintaining race horses, long-term capital loss can be set-off from any other source of income.
- Where any individual transfers directly or indirectly any asset (other than a house property) to the spouse, the income from such asset shall be included in the income of the transferor.
- **Carry-Forward and Set-Off of Losses** If it is not possible to set-off the losses during the same assessment year in which these occurred, so much of the loss as has not been so set-off out of the following losses, can be carried forward to the following assessment year and so on to be set-off against the income of those years provided the losses have been determined in pursuance of a return filed by the assessee and it is the same assessee who sustained the loss.

However, losses suffered under the following heads are not allowed to be carried forward and set off:

- (1) *Losses under the head 'salaries'.*
- (2) *Losses under the head 'Income from other sources'*
(excepting loss suffered from the activity of owning and maintaining race horses).

- W.e.f. assessment year 2000-2001, Section 72A has been substituted by new section to provide for carry forward and set off of accumulated loss and unabsorbed depreciation allowance in case of:
 - (i) amalgamation [Section 72A(1), (2) and (3)], or
 - (ii) demerger [Section 72A(4) and (5)], or
 - (iii) reorganisation of business [Section 72A(6)].
- **Submission of Return for Loss (Section 80):** An assessee is not entitled to carry-forward a loss unless he has filed a return of loss to the Department in time and in the prescribed form. It is obligatory on the part of the assessee to file such return; otherwise he will be deprived of the benefit of carry-forward of losses. In fact, only that amount of loss is allowed to be carried-forward which has been computed by the Assessing Officer and not by the assessee.

SELF TEST QUESTIONS

These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation.

MULTIPLE CHOICE QUESTIONS

1. Under which of the following circumstances transfers of income is revocable?
 - (a) If there is a sale with a condition of re-purchase
 - (b) If the transferor has power to change beneficiary or trustees.
 - (c) Both (a) and (b)
 - (d) Neither (a) nor (b)

2. All income which arises to the minor child shall be clubbed in the income of his/her

- (a) Parents
- (b) Siblings
- (c) Friends
- (d) Neighbors

3. In which case the firm is not entitled to carry forward and set off so much of the loss proportionate to the share of a retired or deceased partner as exceeds his/her share of profits, if any, in the firm in respect of the previous year?

- (a) When a change occurred in constitution of firm
- (b) When a business or profession is succeeded by another person
- (c) When the public are not substantially interested in companies
- (d) None of the above

4. Short term capital loss can be set-off from

- (a) Short-term capital gain
- (b) Long-term capital gain
- (c) Both (a) and (b)
- (d) Neither (a) nor (b)

SHORT NOTES

- (i) Set-off of losses from one source against income from the same source.
- (ii) Set-off of losses against income under the same head.
- (iii) Losses in speculation business
- (iv) Losses of registered firms.
- (v) Carry-forward and set-off of losses in the case of companies.

ELABORATIVE

1. Discuss the tax treatment to transactions which result in (a) transfer of income without transfer of the assets yielding the income; and (b) gift of the assets by an individual to his/her spouse, minor children, major sons and married daughters.
2. Distinguish between revocable and irrevocable transfer of assets and state what is meant by "a revocable transfer" for purposes of income-tax. Discuss also the tax implications arising out of revocable and irrevocable transfer of assets.
3. Discuss the tax effects of creation of a trust by an individual for the benefit of (i) himself, (ii) his/her spouse, (iii) his/her minor children, (iv) his married daughter, (v) his daughter-in-law and sisters.
4. Explain the income-tax implications of converting self-acquired assets into property of a H.U.F. Illustrate.
5. Outline the circumstances under which and the conditions subject to which the total income of an individual should be taken to include the share of income of his/her spouse from a concern in which such individual has substantial interest.
6. What do you mean by "Set-off and carry forward of losses"? which losses can be carried forward?

7. Discuss the provisions of the Income-tax Act relating to the set-off of losses.
 8. Discuss the provisions of the Income-tax Act relating to carry-forward and set-off of losses, with particular reference to the provisions of Section 72A of the Act.

ANSWERS/HINTS

Multiple Choice question

1. (c); 2. (a); 3. (a); 4. (c);

SUGGESTED READINGS

1. Dr. V.K. Singhania : Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.

2. Girish Ahuja and Ravi Gupta : Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.

Lesson 6

Deductions from Gross Total Income

LESSON OUTLINE

- Deductions in relation to various investments are covered under sections 80C to Section 80GGC.
- Deduction in respect of incomes earned from specific source are covered under sections 80HH to 80RRB.
- Deduction in respect of other incomes under section 80TTA.
- Deduction in respect of persons with disability is provided under section 80U.
- Relief and Rebate in respect of Income-tax
- Share of member of an association of persons or body of individuals in the income of the association or body (Section 86)
- Income from an association of persons or a body of individuals (Section 86)
- Relief when salary is paid in arrears or in advance [Section 89]
- Lesson Round Up
- Self Test Questions

LEARNING OBJECTIVES

The deductions from gross total income are available only to the assessees where the gross total income is positive. If however, the gross total income is nil or negative, the question of any deduction from the gross total income does not arise. For this purpose, the expression 'gross total income' means the total income of the assessee computed in accordance with the provisions of the Income-tax Act before making any deduction under Chapter VIA. The aggregate of income computed under each head, after giving effect to the provisions for clubbing of income and set off of losses, is known as "**Gross Total Income**". Sections 80A to 80U of the Income-tax Act lay down the provisions relating to the deductions allowable to assessees from their gross total income. The income arises after deduction under section 80C to 80U is called **Total Income**.

At the end of this lesson, you will learn

- The type of deductions allowable from gross total income
- What are the permissible deductions in respect of payments
- What are the permissible deductions in respect of incomes
- What are the deductions allowable in the case of a person with disability.

The aggregate of income computed under each head, after giving effect to the provisions for clubbing of income and set off of losses, is known as "Gross Total Income". Sections 80A to 80U of the Income-tax Act lay down the provisions relating to the deductions allowable to assessees from their gross total income.

INTRODUCTION

The scheme of the Income-tax Act is to provide for various tax exemptions and concessions in three forms, namely –

- (i) Incomes which are wholly exempt from tax by virtue of their exclusion from the scope of total income under Sections 10 to 13A;
- (ii) Incomes which are includable in the total income for rate purposes but are entitled for rebate under Section 86; and
- (iii) Deductions from gross total income which are allowed for the purposes of computing total income in respect of payments, investment and in respect of certain income.

At the outset, it must be noted that the deductions from gross total income are available only to the assessees where the gross total income is a positive figure. If however, the gross total income is nil or is a loss, the question of any deduction from the gross total income does not arise. For this purpose, the expression 'gross total income' means the total income of the assessee computed in accordance with the provisions of the Income-tax Act before making any deduction under Chapter VIA. The aggregate of income computed under each head, after giving effect to the provisions for clubbing of income and set off of losses, is known as "Gross Total Income". Sections 80A to 80U of the Income-tax Act lay down the provisions relating to the deductions allowable to assessees from their gross total income. However, the aggregate amount of the deductions shall not exceed the gross total income of the assessee.

These deductions are allowed from gross total income after reducing the following incomes from gross total income:

- Long-term Capital Gains
- Short-term Capital Gains under Section 111A
- Lotteries
- Income under Sections 115A, 115AB, 115AC, 115ACA, 115AD, 115BBA, 115D

DEDUCTION ON LIFE INSURANCE PREMIA, CONTRIBUTION TO PROVIDENT FUND, ETC. (SECTION 80C)

Eligibility: (a) an individual; (b) a Hindu undivided family.

Entitlement: Deduction from the Gross Total Income of an amount equal to the investments made, subject to a maximum amount of ₹ One lakh.

Nature of Investments:

- (a) Life Insurance policy taken on the life of an individual assessee or spouse and any child of such individual, and any member of the Hindu Undivided Family. But deduction is not allowed where the premium paid on Life Insurance Policy exceeds 10% of the capital sum assured. However, where the policy, issued on or after the 1st day of April, 2013, is for insurance on life of any person, who is –
 - (a) a person with disability or a person with severe disability as referred to in section 80U, or
 - (b) suffering from disease or ailment as specified in the rules made under section 80DDB
- deduction for premium shall be allowed only when such amount shall not exceed 15% of the capital sum assured.

"actual capital sum assured" in relation to a life insurance policy shall mean the minimum amount assured under the policy on happening of the insured event at any time during the term of the policy, not taking into account--

- (i) the value of any premium agreed to be returned; or
- (ii) any benefit by way of bonus or otherwise over and above the sum actually assured, which is to be or may be received under the policy by any person.

- (b) Amounts paid to effect or to keep in force a contract for a non-commulative deferred annuity not being an annuity plan referred to in clause (j) below on the life of: (i) in the case of an individual, the individual, spouse or any child of such individual and

However, such contract should not contain a provision for exercise of an option by the insured to receive cash payment in lieu of the payment of the annuity.

- (c) Deduction from the salary payable by or on behalf of the Government to any individual, in accordance with the conditions of his service, for securing to him a deferred annuity or making provision for his wife or children, to the extent of one-fifth of salary.

- (d) Any contribution made by an individual only to any provident fund to which the Provident Funds Act, 1925, applies; a Recognised provident fund; an approved superannuation fund.

- (e) Any contribution to (i) any provident fund set-up and notified by the Central Government in the Official Gazette, [public provident fund has been notified for this purpose] or (ii) a ten-year account or a fifteen-year account under the Post Office Savings Bank (Cumulative Time Deposits) Rules, 1959, as amended from time to time, where such sums are deposited/contributions are made to an account standing in the name of: in the case of an individual, the individual himself or a minor of whom he is the guardian; any member of the Hindu Undivided Family in the case of a HUF and in the case of an association of persons or body or individuals, such association or body.

- (f) Subscription to the notified securities of the Central Government.

- (g) Any contribution to a PPF by individual or HUF.

- (h) Subscription to other notified savings certificates defined in Section 2(c) of the Government Savings Certificates Act, 1959 [For this clause, National Savings Certificates (VIII) issue has been notified] and interest accrued deemed to be reinvested also qualifies.

- (i) Contributions made by an individual or HUF, for participation in the Unit-Linked Insurance Plan, 1971, deemed to have been made under Section 19(8)(a) of the Unit Trust of India Act, 1963. [For this clause, Dhanaraksha-1989 plan of LIC Mutual Fund has been notified].

- (j) Contributions made in the name of an individual or HUF for participation in any notified Unit-Linked Insurance Plan of the LIC Mutual Fund.

- (k) Any contribution to effect or keep in force any notified annuity plan of the LIC or any other insurer.

- (l) Any subscription, to any units of any Mutual Fund or the Unit Trust of India under any notified plan formulated by the Central Government.

- (m) Any contribution to any pension fund set up by any Mutual Fund as notified by the Central Government.

- (n) Subscription to the notified deposit scheme of or contribution to any such pension fund set up by the National Housing Bank established under Section 3 of the National Housing Bank Act, 1987. [For this clause, Home Loan Account Scheme of National Housing Bank has been notified].

As inserted by Finance (No. 2) Act, 1991 w.e.f. assessment year 1992-93 any such deposit scheme as notified by the Central Government and floated by:

- (a) a public sector company which is engaged in providing long term finance for construction or purchase of houses in India for residential purposes, or
- (b) any authority constituted in India by or under any law enacted either for the purpose of dealing with and satisfying the need for housing accommodation or for the purpose of planning, development or improvement of cities, towns and villages or for both;
- (o) Only tuition fees (excluding any payment towards any development fees or donation or payment of similar nature), whether at the time of admission or thereafter, –
 - to any university, college, school or other educational institution situated within India;
- (p) For purchase or construction of a residential house property, the income of which is chargeable to tax under the head "Income from House Property", where such payments are made towards or by way of:
 - (i) any instalment or part payment of the amount due under any self- financing or other scheme of any development authority, housing board or other authority engaged in the construction and sale of house property on ownership basis; or
 - (ii) any instalment or part payment of the amount due to any company or co-operative society of which the assessee is a shareholder or member towards the cost of the house property allotted to him; or
 - (iii) re-payment of the amount borrowed by the assessee from: (1) the Central Government or any State Government; or (2) any bank, including a co-operative bank, or (3) the Life Insurance Corporation, or (4) the National Housing Bank, or (5) any public company formed and registered repayment of principal part only not interest in India with the main object of carrying on the business of providing long-term finance for the construction or purchase of houses in India for residential purposes, eligible for deduction under Section 36(1)(viii), or (6) any company in which the public are substantially interested or any co-operative society, where such company or co-operative society is engaged in the business of financing the construction of houses; or (7) the assessee's employer where such employer is a public company or a public sector company or a university established by law or a college affiliated to such university or a local authority or a cooperative society; (8) the assessee's employer where such employer is an authority or a board or a corporation or any other body established under a Central or State Act (w.e.f. A.Y. 2006-07).
 - (iv) stamp duty, registration fee and other expenses for the purpose of transfer of such house property to the assessee.

However, no deduction is allowed in respect of any payment towards or by way of –

- (A) the admission fee, cost of share and initial deposit which a shareholder of a company or a member of a cooperative society has to pay for becoming such shareholder or member; or
- (B) the cost of any addition or alteration to, or renovation or repair of, the house property which is carried out after the issue of completion certificate in respect of the house property by the authority competent to issue such certificate or after the house property or any part thereof has either been occupied by the assessee or any other person on his behalf or has been let out; or
- (C) any expenditure in respect of which deduction is allowable under the provisions of Section 24.
- (q) Subscription to equity shares or debentures or units forming part of any eligible issue of capital i.e. issue made by a company registered in India or a public financial institution or an approved mutual fund for the purpose of developing, maintaining and operating an infrastructure facility as defined in the explanation to Sub-section (4) of Section 80-IA or for generation, or for generation and distribution of power or for providing telecommunication services whether basic or cellular.
- (r) Fixed deposits for a minimum period of 5 years in any Scheduled Banks (w.e.f. A.Y. 2007-08).

- (s) As subscription to such bonds issued by the National Bank for Agriculture and Rural Development, as the Central Government may, by notification in the Official Gazette specify in this behalf.
- (t) In an account under the Senior Citizens Savings Scheme Rules, 2004.
- (u) As five year time deposit in an account under the Post Office Time Deposit Rules, 1981.

In case of any single premium policy, if such policy is surrendered within two years of the date of commencement of insurance, the amount of deduction of income-tax allowed earlier shall be deemed to be the tax payable in the year of surrender.

Consequences of default/failure to pay premium :

Where, in any previous year, an assessee –

- (i) terminates his contract of insurance under the Life Insurance Policy, either by notice to that effect or, where the contract ceases to be in force by reason of failure to pay any premium, by not reviving the contract of insurance, before premiums have been paid for two years; or
- (ii) terminates his participation in any unit-linked insurance plan of U.T.I. or L.I.C. Mutual fund, by notice to that effect or where he ceases to participate by reason of failure to pay any contribution, by not reviving his participation, before contributions in respect of such participation have been paid for five years; or
- (iii) transfers the house property referred to at Sl. No. 'I' as aforesaid, before the expiry of five years from the end of the financial year in which possession of such property is obtained by him, or received back, whether by way of refund or otherwise, any amount specified therein, then –
 - (i) no deduction shall be allowed with reference to any of the sums eligible for deduction and
 - (ii) the deductions of income-tax allowed in respect of the previous year or years preceding such previous year, shall be deemed to be tax payable by the assessee in the assessment year relevant to such previous year and shall be added to the tax on the total income of the assessee with which he is chargeable for such assessment year.
- (iv) if any shares or debentures or units emanating out of an eligible issue of capital to promote infrastructure is transferred within three years of their acquisition the tax rebate allowed on this account shall be deemed to be the tax liability of the previous year in which such premature transfer took place.

Sub-section (3) provides that the provisions of Sub-section (2) shall apply only to so much of any premium or other payment made on an insurance policy other than a contract for a deferred annuity as is not in excess of twenty per cent of the actual capital sum assured.

Explanation. – In calculating any such actual capital sum, no account shall be taken –

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

DEDUCTION FOR CONTRIBUTION TO PENSION FUND (SECTION 80CCC)

An individual who deposits out of his taxable income to any pension fund of the Life Insurance Corporation of India or any insurer, shall get a deduction from his gross total income of the amount so deposited not exceeding ₹ 1,00,000.

DEDUCTION IN RESPECT OF CONTRIBUTION TO PENSION SCHEME OF CENTRAL GOVERNMENT [SECTION 80CCD]

A new pension scheme has been introduced by Finance (No. 2) Act, 2004 which is applicable to new employees

of the Central Government employed on or after 01.01.2004 or any other individual assessee(w.r.e.f 1st april 2009). According to this section, it is mandatory for such employee to contribute 10% of salary every month towards the pension account. A matching contribution is required to be made by the Central Government in this account.

Thus, Section 80CCD makes provision for deduction in respect of contribution to pension scheme of Central Government. Deduction is allowed upto 10% of salary for own contribution and upto 10% of salary for contribution made by the Central Government. Pension/amount received from pension fund, shall be taxable as income in the year in which such amount is received by the assessee or his nominee.

Whereunder the deduction is claimed under this section, no rebate shall be granted in respect of such contribution under Section 88 for any assessment year ending before April 1, 2006. Also, no deduction with reference to such amount shall be allowed under Section 80 for any assessment year beginning on or after April 1, 2006. Salary includes dearness allowance, if terms of employment so provide, but excludes all other allowances and perquisites.

The assessee shall be deemed not to have received any amount in the previous year if such amount is used for purchasing an annuity plan in the same previous year.

LIMIT ON DEDUCTIONS UNDER SECTIONS 80C, 80CCC AND 80CCD (SECTION 80CCE)

The aggregate amount of deductions under Sections 80C, 80CCC and sub-section (1) of 80CCD shall not in any case, exceed one lakh rupees.

DEDUCTION IN RESPECT OF SUBSCRIPTION TO LONG TERM INFRASTRUCTURE BONDS (SECTION 80CCF)

In computing the total income of an assessee, being an individual or a Hindu undivided family, there shall be allowed a deduction of a sum which shall not exceed twenty thousand rupees, paid or deposited, during the previous year relevant to the A.Y 2012-13, as subscription to long-term infrastructure bonds, notified by the Central Government.

No deduction shall be allowed under this section with effect from assessment year 2013-14.

DEDUCTION IN RESPECT OF INVESTMENT MADE UNDER ANY EQUITY SAVING SCHEME (SECTION 80CCG)

Section 80CCG has been inserted with effect from the assessment year 2013-14. Deduction is allowed if the following conditions are satisfied:

1. The assessee is a resident individual
2. His gross total income does not exceed ₹12 Lakh
3. He has acquired listed shares or listed units of an equity oriented funds in accordance with a notified scheme
4. The investment is locked in for a period of 3 years from the date of acquisition in accordance with the above scheme.
5. The assessee satisfies any other condition as may be prescribed.

If the above conditions are satisfied, a deduction will be allowed under section 80CCG. The amount of deduction is 50% of the amount invested in equity shares. However, the amount of deduction under this section cannot be more than ₹ 25,000. The deduction shall be allowed for 3 consecutive assessment years beginning with assessment years in which listed equity shares or units were first acquired.

Note: Equity oriented fund shall have the same meaning assigned in section 10(38).

DEDUCTION IN RESPECT OF MEDICAL INSURANCE PREMIA (SECTION 80D)

(1) In computing the total income of an assessee, being an **individual or a Hindu undivided family**, there shall be deducted such sum, as specified in sub-section (2) or sub-section (3), payment of which is made by any mode as specified in the previous year out of his income chargeable to tax.

(2) Where the assessee is an individual, the sum referred to in sub-section (1) shall be the aggregate of the following:

- (a) the whole of the amount paid to effect or to keep in force an insurance on the health of the assessee or his family or “any contribution made to the *Central Government Health Scheme*” or such other scheme as may be notified by the Central Government in this behalf or *any payment made on account of preventive health check-up of the assessee or his family* and the sum does not exceed in the aggregate ₹15000; and
- (b) the whole of the amount paid to effect or to keep in force an insurance on the health of the parent or parents of the assessee or *any payment made on account of preventive health check-up of the assessee or his family* as does not exceed in the aggregate ₹15,000.

The deduction in respect of payment made on account of preventive health check up shall not exceed ₹ 5,000.

Explanation: family means the spouse and dependent children of the assessee.

Payment shall be made by any mode, including cash, in respect of any sum paid on account of preventive health check-up and by any mode other than cash in all cases other than preventive health check up.

(3) Where the assessee is a Hindu undivided family, the sum referred to in sub-section (1) shall be the whole of the amount paid to effect or to keep in force an insurance on the health of any member of that Hindu undivided family as does not exceed in the aggregate ₹ 15,000.

(4) In case of a senior citizen the amount shall not exceed ₹ 20,000.

Explanation. For the purposes of this sub section, senior citizen means an individual resident in India who is of the age of sixty years or more at any time during the relevant previous year.

DEDUCTION IN RESPECT OF MAINTENANCE INCLUDING MEDICAL TREATMENT OF A DEPENDANT WHO IS A PERSON WITH DISABILITY [SECTION 80DD]

(1) Where an assessee, being an individual or a Hindu undivided family, who is a resident in India, has, during the previous year, –

- (a) incurred any expenditure for the medical treatment (including nursing), training and rehabilitation of a dependant, being a person with disability; or
- (b) paid or deposited any amount under a scheme framed in this behalf by the Life Insurance Corporation or any other insurer or the Administrator or the specified company subject to the conditions specified in Sub-section (2) and approved by the Board in this behalf for the maintenance of a dependant, being a person with disability,

the assessee shall, in accordance with and subject to the provisions of this section, be allowed a deduction of a sum of rupees fifty thousand rupees from his gross total income in respect of the previous year:

Provided that where such dependant is a person with severe disability, the provisions of this sub-section shall have effect as if for the words “fifty thousand rupees”, the words “one hundred thousand rupees” had been substituted.

(2) The deduction under clause (b) of Sub-section (1) shall be allowed only if the following conditions are fulfilled, namely: –

- (a) the scheme referred to in clause (b) of Sub-section (1) provides for payment of annuity or lump sum amount for the benefit of a dependant, being a person with disability, in the event of the death of the individual or the member of the Hindu undivided family in whose name subscription to the scheme has been made;
 - (b) the assessee nominates either the dependant, being a person with disability, or any other person or a trust to receive the payment on his behalf, for the benefit of the dependant, being a person with disability.
- (3) If the dependant, being a person with disability, predeceases the individual or the member of the Hindu undivided family referred to in Sub-section (2), an amount equal to the amount paid or deposited under Clause (b) of Sub-section (1) shall be deemed to be the income of the assessee of the previous year in which such amount is received by the assessee and shall accordingly be chargeable to tax as the income of that previous year.
- (4) The assessee, claiming a deduction under this section, shall furnish a copy of the certificate issued by the medical authority in the prescribed form and manner, along with the return of income under Section 139, in respect of the assessment year for which the deduction is claimed:

Provided that where the condition of disability requires reassessment of its extent after a period stipulated in the aforesaid certificate, no deduction under this section shall be allowed for any assessment year relating to any previous year beginning after the expiry of the previous year during which the aforesaid certificate of disability had expired, unless a new certificate is obtained from the medical authority in the form and manner, as may be prescribed, and a copy thereof is furnished along with the return of income.

Explanation. – For the purposes of this section, –

- (a) **“Administrator”** means the Administrator as referred to in clause (a) of Section 2 of the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002 (58 of 2002);
- (b) **“dependant”** means –
 - (i) in the case of an individual, the spouse, children, parents, brothers and sisters of the individual or any of them;
 - (ii) in the case of a Hindu undivided family, a member of the Hindu undivided family, dependant wholly or mainly on such individual or Hindu undivided family for his support and maintenance, and who has not claimed any deduction under Section 80U in computing his total income for the assessment year relating to the previous year;
- (c) **“disability”** shall have the meaning assigned to it in clause (i) of Section 2 of the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995 (1 of 1996);
- (d) **“Life Insurance Corporation”** shall have the same meaning as in Clause (iii) of Sub-section (8) of Section 88;
- (e) **“medical authority”** means the medical authority as referred to in clause (p) of Section 2 of the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995 (1 of 1996);
- (f) **“person with disability”** means a person as referred to in Clause (f) of Section 2 of the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995 (1 of 1996);
- (g) **“person with severe disability”** means a person with eighty per cent or more of one or more disabilities, as referred to in Sub-section (4) of Section 56 of the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995 (1 of 1996);
- (h) **“specified company”** means a company as referred to in Clause (h) of Section 2 of the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002 (58 of 2002).

DEDUCTION IN RESPECT OF MEDICAL TREATMENT, ETC. (SECTION 80DDB READ WITH RULE 11DD)

Where an individual or HUF who is resident in India has, during the previous year, actually paid any amount for the medical treatment of such disease or ailment as may be specified in the rules made in this behalf by the Board –

- (a) for himself or a dependant, in case the assessee is an individual; or
- (b) for any member of a Hindu undivided family, in case the assessee is a Hindu undivided family,

the assessee shall be allowed a deduction of the amount actually paid or a sum of forty thousand rupees, whichever is less, in respect of that previous year in which such amount was actually paid:

Provided that no such deduction shall be allowed unless the assessee furnishes with the return of income, a certificate in prescribed form (No. 10-I) from a neurologist, an oncologist, a urologist, a haematologist, an immunologist or such other specialist, as may be prescribed, working in a Government hospital:

Provided further that the deduction under this section shall be reduced by the amount received, if any, under an insurance from an insurer, or reimbursed by an employer, for the medical treatment of the person referred to in Clause (a) or Clause (b);

Provided also that where the amount actually paid is in respect of the assessee or his dependant or any member of a Hindu undivided family of the assessee and who is a senior citizen, the provisions of this section shall have effect as if for the words "forty thousand rupees", the words "sixty thousand rupees" had been substituted.

Explanation. – For the purposes of this section, –

- (i) "**dependant**" means –
 - (a) in the case of an individual, the spouse, children, parents, brothers and sisters of the individual or any of them,
 - (b) in the case of a Hindu undivided family, a member of the Hindu undivided family, dependant wholly or mainly on such individual or Hindu undivided family for his support and maintenance;
- (ii) "**Government hospital**" includes a departmental dispensary whether full-time or part-time established and run by a Department of the Government for the medical attendance and treatment of a class or classes of Government servants and members of their families, a hospital maintained by a local authority and any other hospital with which arrangements have been made by the Government for the treatment of Government servants;
- (iii) "**insurer**" shall have the meaning assigned to it in Clause (9) of Section 2 of the Insurance Act, 1938 (4 of 1938);
- (iv) "**senior citizen**" means an individual resident in India who is of the age of sixty years or more at any time during the relevant previous year.

DEDUCTION IN RESPECT OF REPAYMENT OF LOAN TAKEN FOR HIGHER EDUCATION (SECTION 80E)

The deduction of an amount actually paid by an individual during the previous year out of his income chargeable to tax by way of an interest on loan, taken by him from any financial institution or any approved charitable institution for the purpose of pursuing his higher education. The deduction will be available in computing the total income in respect of initial assessment years and the seven assessment years immediately succeeding the initial assessment year or until the interest thereon is paid by such individual in full, whichever is earlier.

The expression "**higher education**" is being defined to mean any course of study pursued after passing the

Senior Secondary Examination or its equivalent from any school, board or university recognised by the Central Government or State Government or local authority or by any other authority authorised by the Central Government or State Government or local authority to do so. The expression "financial institution" is being defined to mean a banking company to which the "Banking Regulation Act, 1949 applies (including any bank or banking institution referred to in Section 51 of the Act) or any other financial institution which the Central Government may, by notification in the Official Gazette, specify in this behalf. The expression "approved charitable institution" is being defined to mean an institution specified in, or as the case may be, an institution established for charitable purposes and notified by the Central Government under Section 10(23C) or an institution referred to in Section 80G(2)(a). The expression "initial assessment year" means the assessment year relevant to the previous year, in which the assessee starts paying the interest on the loan.

"Relative", in relation to an individual, means the spouse and children of that individual or the student for whom the individual is the legal guardian.

Test Your Knowledge



1. What is the upper limit of deduction (including interest) on loan, taken by an individual from any financial institution or any approved charitable institution for the purpose of pursuing his/her higher education?
- ₹ 30,000
 - ₹ 40,000
 - ₹ 50,000
 - Any amount

DEDUCTION IN RESPECT OF INTEREST ON LOAN TAKEN FOR RESIDENTIAL HOUSE PROPERTY (SECTION 80EE)

Interest payable on loan taken by an individual from any financial institution for the purpose of acquisition of a residential house property shall be allowed as deduction under this section on fulfillment of certain conditions [Section 80EE(1)].

Conditions [Section 80EE(3)]

The deduction under section shall be subject to the following conditions, namely

- the loan has been sanctioned by the financial institution during the period beginning on the 1st day of April, 2013 and ending on the 31st day of March, 2014;
- the amount of loan sanctioned for acquisition of the residential house property does not exceed 25 lakh rupees;
- the value of the residential house property does not exceed 40 lakh rupees;
- the assessee does not own any residential house property on the date of sanction of the loan.

Amount of Deduction: The deduction shall not exceed 1 lakh rupees and shall be allowed in computing the total income of the individual for the assessment year 2014-15 and in a case where the interest payable for the previous year relevant to the said assessment year is less than 1 lakh rupees, the balance amount shall be allowed in the assessment year 2015-16 [Section 80EE(2)].

Where a deduction under this section is allowed for any interest, deduction shall not be allowed in respect of such interest under any other provisions of the Act for the same or any other assessment year.

- (a) “*financial institution*” means a banking company to which the Banking Regulation Act, 1949 (10 of 1949) applies including any bank or banking institution referred to in section 51 of that Act or a housing finance company;
- (b) “*housing finance company*” means a public company formed or registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes.

DEDUCTION IN RESPECT OF DONATIONS TO CERTAIN FUNDS, CHARITABLE INSTITUTIONS, ETC. (SECTION 80G)

Deduction under this section is allowed to all type of assessees. Further, Sub-section (5A) of Section 80G clarifies that is a case where an assessee has claimed and has been allowed any deduction under this section in respect of any amount of donation, the same amount will not again qualify for deduction under any other provision of the Act for the same or any other assessment year:

Quantum of deduction:

(A) 100% Deduction without any qualifying limit:

- (i) National Defense fund.
- (ii) Prime Minister’s National relief fund.
- (iii) Prime Minister’s Earthquake relief fund.
- (iv) Africa fund.
- (v) National Trust for welfare of persons with autism, cerebral palsy, mental retardation and multiple disabilities.
- (vi) National cultural fund set up by the Central Government.
- (vii) The Chief Minister’s relief fund or the lieutenant Governor’s relief fund.
- (viii) National Illness Assistance fund.
- (ix) The Andhra Pradesh Chief Minister’s Cyclone Relief Fund, 1996.
- (x) The Army/Air force Central welfare fund or the Indian Naval Benevolent fund.
- (xi) Any fund set up by a State Government to provide medical relief to poors.
- (xii) The National/State Blood transfusion Council.
- (xiii) Zila Saksharta Samiti constituted in any district.
- (xiv) Any fund set up by the State Government of Gujarat, exclusively for providing relief to the victims of earthquake in Gujarat.
- (xv) Maharashtra Chief Minister’s Earthquake Relief Fund.
- (xvi) University/Educational Institute of National Eminence approved by the prescribed authority.
- (xvii) National foundation for communal harmony.
- (xviii) Fund for technology development and application, set up by the Central Government.
- (xix) National sports fund set up by the Central Government.
- (xx) National Children’s Fund.

(B) 50% Deduction without any qualifying limit:

- (i) Jawaharlal Nehru Memorial Fund.
- (ii) Indira Gandhi Memorial Trust.
- (iii) Rajiv Gandhi Foundation.
- (iv) Prime Minister's Drought Relief Fund.

(C) 100% Deduction subject to qualifying limit:

- (i) Any sum to Government or any approved local authority, institution or association to be utilized for promoting family planning.
- (ii) Any sum paid by the assessee, being a company, in the previous year as donation to Indian Olympic Association or to any other association established in India and notified by the Central Government for:
 - I. Development of infrastructure for sports and games or
 - II. Sponsorship of sports and games in India.

(D) 50% Deduction subject to qualifying limit:

- (i) Donation to Government or any approved Local Authority, Institution or Association to be utilized for any Charitable purpose other than promoting family planning.
- (ii) Any other Fund or Institution, which satisfies the conditions of Section 80G(5).
- (iii) Notified Temple, Mosque, Gurudwara, Church or any other place notified by the Central Government to be of historic, as chorological or artistic importance, for renovation or repair of such place.
- (iv) Any corporation established by the Central or State Government specified under Section 10(26BB) for promoting interests of the members of a minority community.
- (v) Any authority constituted in India by or under any law for satisfying the need for housing accommodation or for the purpose of planning development or improvement of cities, towns and villages or for both for applying qualifying limit, all donations made to funds/institutions covered under (C) and (D) above shall be aggregated and the aggregate amount shall be limited to 10% of adjusted Gross Total Income :
 - Adjusted Gross total income means the “Gross Total Income” as reduced by:
 - I. Long-term Capital gains, if any which have been included in the “Gross Total Income”.
 - II. All deductions permissible under Sections 80C to 80U excepting deduction under Section 80G.
 - III. Exempted Income.
 - IV. Income of NRIs and Foreign Companies under Sections 115A, 115AB, 115AC, 115ACA or 115AD.
 - Quantum of deduction: Aggregate of deduction permissible under clauses (A), (B), (C) & (D).

No deduction shall be allowed under this section in respect of donation of any sum exceeding ten thousand rupees unless such sum is paid by any mode other than cash.

Illustration

<i>If Mr. 'A' had income against the following heads,</i>	₹
<i>Taxable salary income</i>	40,000
<i>Income from house property</i>	75,000
<i>Income from other sources</i>	20,000
<i>Interest on securities of DCM Ltd. (Gross)</i>	8,000
	1,43,000

He made following payments:

<i>Contribution to P.F. (recognised)</i>	2,000
<i>Donation to the Prime Minister's National Relief Fund</i>	2,500
<i>Donation to the Indira Gandhi Memorial Trust</i>	4,000
<i>Donation to an approved association for promoting family planning</i>	4,000
<i>Donation to approved charitable trust</i>	10,000

Compute Mr. A's taxable income for assessment year 2014-15.

Solution : His taxable income for assessment year 2014-15 will be computed as follows:

<i>Net income from salary</i>	40,000
<i>Income from house property</i>	75,000
<i>Income from other sources</i>	<u>28,000</u>
Gross Total Income	1,43,000
<i>Less: Deduction under Section 80C</i>	2,000
<i>Less: Deduction permissible: Donation under Section 80G (as worked out below)</i>	<u>13,500</u>
Taxable income	<u>1,27,500</u>
<i>Income-tax on ₹ 1,27,500</i>	NIL
<i>Net tax payable (including Education cess @ 3%)</i>	NIL

Note: Under Section 80G the various items of donations will be dealt with as under:

1. Prime Minister's National Relief Fund deductible in full without any restrictions.
2. Donation to Indira Gandhi Memorial Trust is deductible to the extent of 50% of donation without any restrictions.
3. Donation to approved family planning association is deductible in full so long as it is within the 10% limit imposed by Section 80G(4).
4. Donation to an approved charitable trust is deductible to the tune of 50% so long as it is also within the limit imposed by Section 80G(4).

Calculation of deduction under Section 80G:

	(₹)	(₹)
Gross total income	1,43,000	
Less: Deduction under Sections 80C to 80U	<u>2,000</u>	
Adjusted gross total income	<u>1,41,000</u>	
(i) Donation on which qualifying limit is not applicable:		
(A) Allowed @ 100%		
I. Prime Minister's National Relief Fund	2,500	
(B) Allowed @ 50%		
I. Indira Gandhi Memorial Trust (4000)	2,000	
(ii) Donation to which qualifying limit is applicable:		
(1) For promotion of family planning	4,000	
(2) Charitable trust	<u>10,000</u>	
	14,000	

Limited to 10% of Adjusted Gross Total Income:

i.e. ₹ 14,100/- Since donation to family planning are lowest than maximum allowable. Therefore, allowable amount is (4,000 + 5,000) ₹ 9,000/- 9,000

Total Deduction for Section 80G 13.500

DEDUCTION IN RESPECT OF RENT PAID (SECTION 80GG)

Deductions admissible under this Section is:

- Actual rent paid less 10% of 'Adjusted Total Income'.
- 25% of such 'Adjusted Total Income'.
- Amount calculated at ₹ 2,000 p.m.

whichever is least.

Adjusted Total Income means the Gross total income as reduced by long term capital gain if included in the gross total income and income referred to in section 115A to 115D and the amount of deduction under section 80C other than deduction under this section.

However, certain conditions as given below are required to be fulfilled/satisfied for claiming deduction u/s 80GG

- The assessee should not be receiving any house rent allowance exempt u/s 10(13A) or rent free accommodation.
- The accommodation should be occupied by the assessee for the purpose of his own residence.
- The assessee fulfills such other conditions or limitations as may be prescribed having regard to the area or place in which such accommodation is situated and other relevant consideration.

- The assessee or his spouse or his minor child or an HUF of which he is a member does not own any accommodation at the place where he ordinarily resides or performs duties of his office or employment or carries on his business or profession.
- If the assessee owns any accommodation at any place other than that referred to above, such accommodation should not be in the occupation of the assessee and its annual value is not required to be determined under Section 23(2)(a)(i) or Section 23(2)(b).
- Allowed only to an individual assessee after furnishing Form 10BA along with return of income.

DEDUCTION IN RESPECT OF CERTAIN DONATIONS FOR SCIENTIFIC RESEARCH OR RURAL DEVELOPMENT (SECTION 80GGA)

An assessee (other than an assessee whose gross total income includes income chargeable under the head "profits and gains of business or profession") is entitled to 100% deduction in the computation of his total income in respect of the following payments/donations:

- (a) Sums paid to a research association which has, as its object the undertaking of scientific research, or to a university, college or other institution to be used for scientific research where such association, university, college or institution has been approved by the prescribed authority for the purpose of Section 35(1)(ii).
- (b) As inserted by Finance (No. 2) Act, 1991 with effect from 1.4.1992, any sum paid by the assessee in the previous year to a research association which has as its object the undertaking of research in social science or statistical research or to a University or college or other institution to be used for social science or statistical research where such association or university college or institution is for the time being approved by the prescribed authority for the purpose of Section 35(1)(iii).
- (c) Sums paid to an approved association or institution which has as its object the undertaking of any programme of rural development, to be used for the purposes of carrying out any programme of rural development approved for the purposes of Section 35CCA provided the assessee furnishes the certificate referred to in Section 35CCA(2).
- (d) Sums paid to an approved association or institution which has as its object the undertaking of any programme of rural development provided the assessee furnishes a certificate referred to in Section 35CCA(2A).
- (e) As inserted by the Finance (No. 2) Act, 1991 from the assessment year 1992-93, any sum paid by the assessee in the previous year to a public sector company or a local authority or an association or institution approved by the National Committee for carrying out any eligible project or scheme, provided the assessee furnishes a certificate referred to in Section 35AC(2)(a).

For the purposes of this clause, 'National Committee' means the committee constituted by the Central Government from amongst persons of eminence in public life, in accordance with the rules made under Income-tax Act, 1961 and "eligible project or scheme" means such project or scheme for promoting the social and economic welfare of, or the uplift of, the public as may be notified by Central Government on the recommendations of the National Committee.

- (f) Sums paid before April 1, 2002 to an approved association or institution which has as its object the undertaking of any programme of conservation of natural resources or afforestation to be used for carrying out any programme of conservation of natural resources or of afforestation approved under Section 35CCB(2).
- (g) Sums paid to the National Fund for Rural Development set up and notified by the Central Government for the purpose of carrying out rural development. This section also provides that where deduction under this section is claimed and allowed, deduction will not be allowed in respect of the same payment

under any other provision of the Act for the same or any other assessment year.

- (h) any sum paid by the assessee in the previous year to the National Urban Poverty Eradication Fund set up and notified by the Central Government.

No deduction shall be allowed under this section in respect of any sum exceeding ten thousand rupees unless such sum is paid by any mode other than cash.

DEDUCTION IN RESPECT OF CONTRIBUTIONS GIVEN BY COMPANIES TO POLITICAL PARTIES OR AN ELECTORAL TRUST(SECTION 80GGB)

Any sum contributed by an Indian Company in the previous year to any political party or to an electoral trust shall be allowed as deduction while computing its total income.

Note : Sum contributed by way of cash shall not be allowed as deduction.

DEDUCTION IN RESPECT OF CONTRIBUTIONS GIVEN BY ANY PERSON TO POLITICAL PARTIES OR AN ELECTORAL TRUST (SECTION 80GGC)

Any amount of contribution made by an assessee being any person to a political party or an electoral trust except local authority and every artificial juridical person wholly or partly funded by the Government shall be allowed as deduction while computing the total income of such person.

Note : Sum contributed by way of cash shall not be allowed as deduction.

DEDUCTION IN RESPECT OF PROFITS AND GAINS FROM INDUSTRIAL UNDERTAKINGS OR ENTERPRISE ENGAGED IN INFRASTRUCTURE DEVELOPMENT (SECTION 80-IA)

A deduction will be allowed from gross total income to an assessee in respect of profits and gains derived from any business of:

(1) Infrastructure facility: The enterprise is carrying on the business of operating any infrastructure facility which fulfills the following conditions:

- (a) It is owned by an Indian company or consortium of companies or by an authority or a board or a corporation or any other body established or constituted under any Central or State Act registered in India;
- (b) It enters into an agreement with the Central or State Government or a local authority or any other statutory body for (i) developing, (ii) operating and maintaining, (iii) developing, operating and maintaining, a new infrastructure facility.
- (c) It transfers such infrastructure facility after the period stipulated in the agreement to such Government or authority or body concerned;
- (d) It starts operating and maintaining the infrastructure facility on or after 1st April, 1995.

It has entered into an agreement with the Central Government or a State Government or a local authority or any other statutory body for developing a special economic zone and maintaining a new infrastructure facility.

Where an infrastructure facility is transferred after 31.3.1999 by an enterprise which has developed it to another enterprise for operating and maintaining it on its behalf, in accordance with the agreement with person mentioned in (b), the transferee will get the benefit of deduction for the unexpired period.

*Explanation – For the purposes of this clause, “**infrastructure facility**” means:*

- (a) a road including toll road, a bridge or a rail system;
- (b) a highway project including housing or other activities being an internal part of the highway project;

- (c) a water supply project, water treatment system, irrigation project, sanitation and sewerage system or solid waste management system;
- (d) a port, airport, inland waterway or inland port.

W.e.f. Assessment year 2001-02, infrastructure facility shall also include water treatment system and solid waste management system.

The benefit of deduction to housing and other development activities which are an internal part of a highway project shall be allowed if the following conditions are satisfied:

- (a) Such profits are transferred to a special reserve account.
- (b) Such profits are utilised for highway project, excluding housing and other activities, before the expiry of three years following the year in which the amount was transferred to the reserve account.

The amount remaining unutilised shall be chargeable to tax as income of the year in which it was transferred to the reserve account.

(2) Telecommunication services: Any undertaking which has started or starts providing telecommunication services whether basic or cellular including radio-paging, domestic satellite service or network of trunking and electronic data interchange services at any time after 31.3.1995 but before 31.3.2005.

Domestic Satellite Service means a satellite owned and operated by an Indian Company for providing telecommunication services.

(3) Industrial park: Any undertaking which develops a special economic zone and operates an industrial park (notified by the Central Government) after 31.3.1997 but before 1.4.2006 and in case of SEZ, it should begin on or after 1.4.2001 but before 1.4.2006.

Where an undertaking develops industrial park after 31.3.1999 and transfers the operations and maintenance of it to another undertaking, the transferee will get the benefit of deduction for the unexpired period.

However, Investments made to develop industrial park has been extended from 31.3.2006 to 31.3.2011.

(4) Generation and distribution of power: An undertaking which:

- (a) is set-up in any part of India for the generation or generation and distribution of power if it begins to generate power at any time during the period beginning on the 1st day of April, 1993 and ending on the 31st day of March 2014.
- (b) starts transmission or distribution by laying a network of new transmission or distribution lines at any time during the period beginning on the 1st day of April, 1999 and ending on the 31st day of March 2014.
- (c) undertakes substantial renovation and modernization of the existing network of transmission or distribution lines at any time during the period beginning on the 1st day of April, 2004 and ending on the 31st day of March, 2014.

Provided that the deduction under this section to an industrial undertaking under sub-clause (b) shall be allowed only in relation to the profits derived from laying of such network of new lines for transmission or distribution.

Quantum and period of deduction:

- (1) First five assessment years - 100% of such profits.
- (2) Next five assessment years - In case of companies 30% of such profits. In case of other assessee 25% of such profits.

The deduction under (4) above shall be allowed if the following conditions are satisfied:

- (a) It is not formed by the splitting up, or the reconstruction, of a business already in existence;
- (b) it is not formed by the transfer to a new business of machinery or plant (exceeding 20%) previously used for any purpose.

(5) Re-construction or revival of a power generating plant

- (i) Such undertaking must be owned by an Indian Company, formed before 30.11.2005 with majority equity participation by public sector companies for the purpose of enforcing the security interest of the lenders to the company owning the power generation plant.
- (ii) Such Indian Company is notified before 31.12.2005 by the Central Government for the purposes of this clause and begins to generate or transmit or distribute power before 31.3.2011(w.r.e.f 1st April 2008 by Finance Act 2009.

Option to claim deduction: The assessee, at his option, can claim deduction in any ten consecutive assessment years out of fifteen years beginning from the year in which it begins operations.

If the assessee is engaged in infrastructure facility mentioned in (b) above he can claim deduction in any ten consecutive assessment years out of twenty years instead of out of fifteen years.

Computation of Income for Deduction: For the purpose of computing the deduction at the specified percentage for the assessment year immediately succeeding the initial assessment year and any subsequent assessment year, the profits and gains will be computed as if such business were the only source of income of the assessee in all the assessment years for which the deduction at the specified percentage under this section is available.

It means if the loss or any allowance (e.g., depreciation allowance) of such business is set-off against any other income in an earlier assessment year to find out the income of the current year for deduction under this section the loss so set-off shall be deducted from the current year's income and on the balance so arrived, the deduction shall be computed.

Where goods held for the purpose of eligible business are transferred to any other business of the assessee, or vice-versa, such transfer is required to be done at the market value of such goods. If such goods are not transferred at market value on the date of transfer, then the profits and gains of such eligible business shall be recomputed as if transfer has been made at the market value of such goods, as on that date.

If in the opinion of the Assessing Officer, such recomputation presents exceptional difficulties, the Assessing Officer may compute such profits and gains on such reasonable basis as he may deem fit.

Market Value in relation to any goods or services, means

- (i) *the price that such goods or services would ordinarily fetch in the open market; or*
- (ii) *the arm's length price as defined in clause (ii) of section 92F, where the transfer of such goods or services is a specified domestic transaction referred to in section 92BA.*

Where deduction to an industrial undertaking or an enterprise for profit and gains is allowed under this section for any assessment year, deduction to that extent shall not be allowed under any other provision of chapter VIA under the heading deductions in respect of certain incomes.

The deduction shall not exceed the profit and gains of such eligible business of industrial undertaking or enterprise. If the profit shown for the eligible business under this section, appears to the assessing officer as more than the ordinary profits which might be expected to arise in such eligible business, owing to some close connection with a person with whom business transactions are so arranged to yield higher profit, the assessing officer may take the amount of profits as may be reasonably derived therefrom.

Where any undertaking of an Indian company which is entitled to deduction under this section is transferred,

before the expiry of the period of tax holiday, to another Indian company in a scheme of amalgamation or demerger, then the deduction will be available as follows:

- (i) No deduction shall be admissible under this section to the amalgamating company/demerged company for the previous year in which amalgamation/ demerger takes place.
- (ii) The amalgamated company or resulting company will be entitled to claim deduction under this section for the unexpired period of tax holiday (including for the previous year in which the amalgamation/ demerger takes place). The provisions of the section shall, as far as may be, apply to the amalgamated or resulting company as they would have applied to the amalgamating or demerged company as if the amalgamation or demerger had not taken place.

Provided that in a case where an undertaking develops an industrial park on or after the 1st day of April, 1999 or a special economic zone on or after the 1st day of April, 2001 and transfers the operation and maintenance of such industrial park or such special economic zone, as the case may be, to another undertaking (hereafter in this section referred to as the transferee undertaking), the deduction under Sub-section (1) shall be allowed to such transferee undertaking for the remaining period in the ten consecutive assessment years as if the operation and maintenance were not so transferred to the transferee undertaking.

The provisions contained in this section shall not apply to any special economic notified on or after the 1st day of April, 2005 in accordance with the scheme referred to in sub-clause (iii) of clause (c) of Sub-section (4).

DEDUCTION IN RESPECT OF PROFIT AND GAINS BY AN UNDERTAKING A ENTERPRISE ENGAGED IN DEVELOPMENT OF SPECIAL ECONOMIC ZONE [SECTION 80-IAB]

According to Section 80-IA(13), any undertaking which develops notified SEZ on or after 1.4.2005, will not be eligible to claim deduction u/s 80-IA.

Now, those undertaking, which develops SEZ, notified on or after 1.4.2005 under the special economic zones Act, 2005 will be eligible to claim deduction under the new Section 80-IAB.

Quantum of deduction: The deduction shall be allowed of an amount equal to 100% the profit and gains derived from such business for 10 consecutive assessment years, out of 15 years beginning from the year in which a SEZ has been notified by the central government, at option of the assesses.

DEDUCTION IN RESPECT OF PROFITS AND GAINS FROM CERTAIN INDUSTRIAL UNDERTAKINGS OTHER THAN INFRASTRUCTURE DEVELOPMENT UNDERTAKINGS [SECTION 80-IB]

The deduction under section 80-IB is available to an assessee whose gross total income includes profits and gains derived from the following business. The deduction equal to such percentage and for such number of assessment years as given below:

Deduction under Section 80-IB is available to different industrial undertakings as follows:

- (i) *business of an industrial undertaking*
- (ii) *operation of ship*
- (iii) *hotels*
- (iv) *Scientific research*
- (v) *production of mineral oil*
- (vi) *developing and building housing projects.*

(vii) *Cold Chain facility for agriculture produce..*

(viii) *Multiplex theaters.*

(ix) *Convention Centre*

(x) *Hospital in Rural area.*

(xi) *Hospital anywhere in India.*

An industrial undertaking should be mainly engaged in the business of construction of ships or in the manufacture or processing of goods or in mining. Construction of dam, bridge, road or building cannot be characterised as manufacture or production of articles.

The Industrial undertaking claiming deduction under this section, however need to fulfill the following conditions:

1. It is not formed by splitting up, or the reconstruction, of a business already in existence. This condition is not violated, where the business is re-established, reconstructed or revived by the same assessee after the business of any industrial undertaking carried on by him in India is discontinued due to extensive damage to or destruction of, any building, machinery, plant or furniture owned by the assessee (and used for the purpose of such business) as a direct result of (i) flood, typhoon, hurricane, cyclone, earthquake or other convulsion of nature, or (ii) riot or civil disturbance, or (iii) accidental fire or explosion, or (iv) action by any enemy or action taken in combating an enemy (whether with or without a declaration of war).
2. It is not formed by the transfer to a new business of machinery or plant previously used for any purpose. However, plant and machinery, already used for any purpose, can be transferred to the new industrial undertaking, provided value of such plant and machinery does not exceed 20% of the total value of plant and machinery of the new industrial undertaking.
3. It manufactures or produces any article or thing, not being any article or thing specified in the list in the Eleventh Schedule, or operates one or more cold storage plant or plants, in any part of India. However, a small scale industrial undertaking or an industrial undertaking located in an industrially backward state specified in the Eighth Schedule shall be eligible for the deductions, even if it manufactures or produces any article/thing which is specified in the Eleventh Schedule.
4. The undertaking employs ten or more workers in a manufacturing process carried on with the aid of power or employs twenty or more workers in a manufacturing process carried on without the aid of power.

I. The amount of deduction to industrial undertaking shall be as follows :

Sl. Industrial No. Undertaking	Period within which production should start	Period of deduction (commencing from initial assessment year)	%age of profit eligible for deduction
(1) (2)	(3)	(4)	(5)
(i) Any industrial undertaking			
Owned by a company	1.4.1991 to 31.3.1995* (or any further notified period)	Ten consecutive assessment year	30%
Owned by a co-operative society		Twelve consecutive assessment year	25%

Any other assessee		Ten consecutive assessment year	25%
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*However where it is an industrial undertaking being a small scale industrial undertaking, it begins to manufacture or produce article or things or to operate its cold storage plant (other than those specified below) the period shall be construed as the period beginning on 1.4.95 and ending on 31.3.2002.

(ii) Industrial undertaking set up in an industrial backward state specified in Eighth Schedule*

Owned by a company Owned by a co-operative society Any other assessee	1.4.1993 to 31.3.2002 (extended to 31.3.2012 only in J&K)	First five years Next five years First five years Next seven years First five years Next five years	100% 30% 100% 25% 100% 25%

*However in case of notified industries in the North-Eastern Region, the amount of deduction shall be hundred percent of profits for a period of ten assessment years.

(iii) Industrial undertaking located in notified industrially backward districts of Category A

Owned by a company Owned by a co-operative society Any other assessee	1.10.1994 to 31.3.2004	First five years Next five years First five years Next seven years First five years Next five years	100% 30% 100% 25% 100% 25%

(iv) Industrial undertaking located in notified industrially backward districts of Category B

Owned by a company Owned by a co-operative society Any other assessee	1.10.1994 to 31.3.2004	First three years Next five years First three years Next nine years First three years Next five years	100% 30% 100% 25% 100% 25%

II. Deduction under this section shall also be available in the case of the business of a ship @ 30% of the profits and gains derived from such ship for a period of ten consecutive assessment years including the initial assessment year.

However, to claim deduction it is required that the ship –

- is owned by an Indian company and is wholly used for the purposes of the business carried on by it.
- was not, previous to the date of its acquisition by the Indian company, owned or used in Indian territorial waters by a person resident in India.

- (iii) is brought into use by the Indian company at any time during the period beginning on the 1.4.1991 and ending on 31.3.1995.

Sl. No.	Type of Hotel	Period within which functioning should start	Period of deduction (commencing from initial assessment year)	Profit eligible for deduction
(i)	Hotel located in a hilly area or a rural area or a place of pilgrimage or any other place notified by Central Government having regard to the need for development of infrastructure for tourism in any place and other relevant consideration.	1.4.1990 to 31.3.1994	Ten consecutive years	50%
(ii)	Hotel located in a hilly area or a rural area or a place of pilgrimage or any other place notified by Central Government. However, such hotel should not be located within Municipal Jurisdiction of Calcutta, Chennai, Delhi and Mumbai. Such hotel should however be approved by the prescribed authority.	1.4.1997 to 31.3.2001	Ten consecutive years	50%
(iii)	Hotel located in any place other than those mentioned in (i) above	1.4.1991 to 31.3.1995	Ten consecutive years	30%
(iv)	Hotel located in any other place other than those mentioned in (i) above. However, such hotel should not be located within Municipal Jurisdiction of Calcutta, Chennai, Delhi and Mumbai.	1.4.1997 to 31.3.2001	Ten consecutive years	30%

However, the following conditions need to be satisfied by a hotel in order to claim deduction:

- (i) The business of the hotel is not formed by the splitting up; or the reconstruction of a business already in existence or by the transfer to a new business of a building previously used as a hotel or of any machinery or plant previously used for any purpose.
- (ii) The business of hotel is owned and carried on by a company registered in India with a paid up capital of not less than ₹ 5 lakhs.
- (iii) The hotel is for the time being approved by the prescribed authority. Any hotel approved before 1.4.99 shall be deemed to have been approved for the purpose of this section.

IV. Deduction in the case of any company carrying on scientific research and development is available @ 100% of the profits and gains of such business for a period of five assessment years beginning from the initial assessment year. However, to claim deduction under this section, it is required that such a company –

- (i) is registered in India.

- (ii) has the main object of scientific and industrial research and development.
- (iii) is for the time being approved by the prescribed authority at any time before 1.4.1999.

Further, the amount of deduction in the case of any company carrying on scientific research and development shall be hundred per cent of the profits and gains of such business for a period of ten consecutive assessment years, beginning from the initial assessment year, if such company—

- (i) is registered in India;
- (ii) has its main object the scientific and industrial research and development;
- (iii) is for the time being approved by the prescribed authority at any time after the 31st day of March, 2000, but before the 1st day of April, 2007;
- (iv) fulfills such other conditions as may be prescribed.

IV. Industrial undertaking producing or refining mineral oil in the North Eastern Region or in any part of India:

The amount of deduction to an undertaking shall be 100% of the profits for a period of seven consecutive assessment years, including the initial assessment year, if such undertaking fulfils any of the following conditions:

- (i) is located in North-Eastern Region and has begun or begins commercial production of mineral oil before the 1st day of April, 1997;
 - (ii) is located in any part of India and has begun or begins commercial production of mineral oil on or after the 1st day of April, 1997;
- Provided that the provisions of this clause shall not apply to blocks licensed under a contract awarded after the 31st day of March, 2011 under the New Exploration Licencing Policy announced by the Government of India vide Resolution No. O-19018/22/95-ONG.DO.VL, dated the 10th February, 1999 or in pursuance of any law for the time being in force or by the Central or a State Government in any other manner;
- (iii) is engaged in refining of mineral oil and begins such refining on or after the 1st day of October, 1998 but not later than 31st day of March 2012..(w.e.f Assessment year 2001-02) (the words "but not later than the 31st day of March, 2012" shall be inserted w.r.e.f 1st April 2009);
 - (iv) is engaged in commercial production of natural gas in blocks licensed under the VIII Round of bidding for award of exploration contracts (hereafter referred to as "NELP-VIII") under the New Exploration Licencing Policy announced by the Government of India vide Resolution No. O-19018/22/95-ONG.DO.VL, dated 10th February, 1999 and begins commercial production of natural gas on or after the 1st day of April, 2009.
 - (v) is engaged in commercial production of natural gas in blocks licensed under the IV round if bidding for award of exploration contracts for Coal Bed Methane blocks and begins commercial production of natural gas on or after the 1st day of April 2009.

Explanation: All blocks licensed under a single contract, which has been awarded under the New Exploration Licencing Policy announced by the Government of India vide Resolution No. O-19018/22/95-ONG.DO.VL, dated 10th February, 1999 or has been awarded in pursuance of any law for the time being in force or has been awarded by Central or a State Government in any other manner, shall be treated as a single undertaking.

V. Deduction of 100% of the profits of an undertaking engaged in developing and building housing projects approved before the 31st day of March, 2008 by a local authority provided that:

- (a) such undertaking has commenced or commences development and construction of the housing project on or after 1st day of October, 1998 and completes such construction—
 - (i) in case where a housing project has been approved by the local authority before the 1st day of April, 2004, on or before 31st day of March, 2008;
 - (ii) in a case where a housing project has been or, is approved by the local authority on or after the 1st day of April, 2004 but not later than the 31st March 2005, within four years from the end of financial year in which the housing project is approved by the local authority.
 - (iii) In a case where a housing project has been approved by the local authority on or after the 1st day of April, 2005, within five years from the end of the financial year in which the housing project is approved by the local authority.
- (b) the project is of the size of a plot of land which has minimum area of one acre;
- (c) the residential unit has a maximum built-up area of one thousand square feet where such residential unit is situated within the cities of Delhi or Mumbai or within twenty-five kilometers from the municipal limits of these cities and one thousand and five hundred square feet at any other place; and
- (d) the build-up area of the shops and other commercial establishments included in the housing project does not exceed three of the aggregate built-up area of the housing project or five thousand square feet whichever is higher.
- (e) not more than one residential unit in the housing project is allotted to any person not being an individual; and
- (f) in a case where a residential unit in the housing project is allotted to a person being an individual, no other residential unit in such housing project is allotted to any of the following persons,
 - (i) the spouse or the minor children of such individual,
 - (ii) the Hindu undivided family in which such individual is the karta,
 - (iii) any person representing such individual, the spouse or the minor children of such individual or the Hindu undivided family in which such individual is the karta.

VI. Hundred percent of the profits and gains derived by an industrial undertaking from the business of setting up and operating a cold chain facility for agricultural produce shall be deductible:

<i>Industrial Undertaking</i>	<i>Period within which production should start</i>	<i>Period of deduction (commencing from initial assessment year)</i>	<i>%age of profit eligible for deduction</i>
For a company	1.4.1999 to 31.3.2003	First five years	100%
		Next five years	30%
For a co-operative society		First five years	100%
Next seven years			25%
Any other assessee		First five years	100%
Next five years			25%

Where any undertaking of an Indian company which is entitled to the deduction under this section is transferred, before the expiry of the period specified in this section, to another Indian company in a scheme of amalgamation or demerger –

- (a) no deduction shall be admissible under this section to the amalgamating or the demerged company for the previous year in which the amalgamation or the demerger takes place; and
- (b) the provisions of this section shall as far as may be apply to the amalgamated or the resulting company as they would have applied to the amalgamating or the demerged company if the amalgamation or demerger had not taken place.

Further, the amount of deduction in a case of an undertaking deriving profit from the integrated business of handling, storage and transportation of foodgrains, shall be hundred per cent of the profits and gains derived from such undertaking for five assessment years beginning with the initial assessment year and thereafter, twenty-five per cent (or thirty per cent, where the assessee is a company) of the profits and gains derived from the operation of such business in a manner that the total period of deduction does not exceed ten consecutive assessment years and subject to fulfillment of the condition that it begins to operate such business on or after the 1st day of April, 2001.

In the case of an undertaking engaged in the integrated business of handling, storage and transportation of foodgrains, means the assessment year relevant to the previous year in which the undertaking begins such business.

VII. Deduction in the case of any multiplex theatre

Fifty per cent of the profits and gains derived, from the business of building, owning and operating a multiplex theatre, for a period of five consecutive years beginning from the initial assessment year in any place. Multiplex theatre should not be located at a place within the municipal jurisdiction of Kolkata, Chennai, Delhi or Mumbai. Such multiplex theatre should be constructed at any time during the period beginning on the 1st day of April, 2002 and ending on the 31st day of March, 2005. The business should not be formed by splitting up or the reconstruction, of a business or any plant and machinery previously used for any purpose, and assessee should furnish alongwith the return of income, the report of an audit in Form No. 10CCBA.

VIII. Deduction in the case of any convention centre:

Fifty per cent of the profits and gains derived, by the assessee from the business of building, owning and operating a convention centre, for a period of five consecutive years beginning from the initial assessment year. Such convention centre is constructed at any time during the period beginning on the 1st day of April, 2002 and ending on the 31st day of March, 2005. The business should not be formed by splitting up or the re-construction of a business or any plant and machinery previously used for any purpose.

IX. 100% deduction in case of an undertaking deriving profits from the business of operating and maintaining a hospital in a rural area for a period of five consecutive assessment years beginning with the initial assessment year if (w.e.f. A.Y. 2005-06) –

- (i) such hospital is constructed at any time during the period from 1.10.2004 to 31.3.2008.
- (ii) the hospital has atleast one hundred beds for patients.
- (iii) construction of hospital is in accordance with the regulations, for the time being in force, of the local authority; and
- (iv) the assessee furnishes alongwith the return of income the report of audit in such form and containing such particulars as may be prescribed and duly signed and verified by a chartered accountant that the deduction has been correctly claimed.

X. The amount of deduction in the case of an undertaking deriving profits from the business of operating and maintaining a hospital located anywhere in India, other than the excluded area, shall be hundred per cent of the profits and gains derived from such business for a period of five consecutive assessment years, beginning with the initial assessment year, if –

- (i) the hospital is constructed and has started or starts functioning at any time during the period beginning on the 1st day of April, 2008 and ending on the 31st day of March, 2013;
- (ii) the hospital has at least one hundred beds for patients;
- (iii) the construction of the hospital is in accordance with the regulations or bye-laws of the local authority; and
- (iv) the assessee furnishes along with the return of income, a report of audit in such form and containing such particulars, as may be prescribed, and duly signed and verified by an accountant, as defined in the Explanation to sub-section (2) of section 288, certifying that the deduction has been correctly claimed.

Test Your Knowledge



2. Deduction under Section 80-IB is available to:

- (a) Charitable Trust
- (b) Tour and Travels
- (c) Industrial Research
- (d) Convention Centre

3. Which of the following gets 50% deduction on the profits and gains derived from its business for a period of five consecutive years beginning from the initial assessment year in any place?

- (a) Multiplex Theatre
- (b) Convention Centre
- (c) Hospital
- (d) Charitable Trust

SPECIAL PROVISIONS IN RESPECT OF CERTAIN UNDERTAKINGS OR ENTERPRISES IN CERTAIN SPECIAL CATEGORY STATES [SECTION 80-IC]

(1) Where the gross total income of an assessee includes any profits and gains derived by an undertaking or an enterprise from any business referred to in Sub-section (2), there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, a deduction from such profits and gains, as specified in Sub-section (3).

(2) This section applies to any undertaking or enterprise, –

- (a) which has begun or begins to manufacture or produce any article or thing, not being any article or thing specified in the Thirteenth Schedule, and undertakes substantial expansion during the period beginning—
 - (i) on the 23rd day of December, 2002 and ending before the 1st day of April, 2012, in any specified areas, in the State of Sikkim; or
 - (ii) on the 7th day of January, 2003 and ending before the 1st day of April, 2012, in any specified areas, in the State of Himachal Pradesh or the State of Uttarakhand; or
 - (iii) on the 24th day of December, 1997 and ending before the 1st day of April, 2007, in any specified areas, in any of the North-Eastern States;

Specified area means any Export Processing Zone or Integral Infrastructure Development Centre or Industrial Growth Centre or Industrial Park or Theme Park, as notified by the Board in accordance with the scheme framed and notified by the central government in this regard.

- (b) which has begun or begins to manufacture or produce any article or thing, specified in the Fourteenth Schedule or commences any operation specified in that Schedule, and undertakes substantial expansion during the period beginning –
 - (i) on the 23rd day of December, 2002 and ending before the 1st day of April, 2012, in the State of Sikkim; or
 - (ii) on the 7th day of January, 2003 and ending before the 1st day of April, 2012, in the State of Himachal Pradesh or the State of Uttarakhand; or
 - (iii) on the 24th day of December, 1997 and ending before the 1st day of April, 2007, in any of the North-Eastern States.
- (3) The deduction referred to in Sub-section (1) shall be –
 - (i) in the case of any undertaking or enterprise referred to in Sub-clauses (i) and (iii) of Clause (a) or Sub-clause (i) and (iii) of Clause (b), of Sub-section (2), 100% of such profits and gains for ten assessment years commencing with the initial assessment year;
 - (ii) in the case of any undertaking or enterprise referred to in Sub-clause (ii) of Clause (a) or Sub-clause (ii) of Clause (b), of Sub-section (2), 100% of such profits and gains for five assessment years commencing with the initial assessment year and thereafter, 25% (or 30% where the assessee is a company) of the profits and gains.
- (4) This section applies to any undertaking or enterprise which fulfils all the following conditions, namely:—
 - (i) it is not formed by splitting up, or the reconstruction, of a business already in existence;

Provided that this condition shall not apply in respect of an undertaking which is formed as a result of the re-establishment, reconstruction or revival by the assessee of the business of any such undertaking as is referred to in Section 33B, in the circumstances and within the period specified in that section;
 - (ii) it is not formed by the transfer to a new business of machinery or plant previously used for any purpose.

Explanation. – The provisions of Explanations 1 and 2 to Sub-section (3) of Section 80-IA shall apply for the purposes of Clause (ii) of this sub-section as they apply for the purposes of Clause (ii) of that sub-section.
- (5) Notwithstanding anything contained in any other provision of this Act, in computing the total income of the assessee, no deduction shall be allowed under any other section contained in Chapter VIA or in Section 10A or Section 10B, in relation to the profits and gains of the undertaking or enterprise.
- (6) Notwithstanding anything contained in this Act, no deduction shall be allowed to any undertaking or enterprise under this section, where the total period of deduction inclusive of the period of deduction under this section, or under the second proviso to Sub-section (4) of Section 80-IB or under Section 10C, as the case may be, exceeds ten assessment years.
- (7) The provisions contained in Sub-section (5) and Sub-sections (7) to (12) of Section 80-IA shall, so far as may be, apply to the eligible undertaking or enterprise under this section.
- (8) For the purposes of this section, –
 - (i) “**Industrial Area**” means such areas, which the Board, may by notification in the Official Gazette, specify in accordance with the scheme framed and notified by the Central Government;
 - (ii) “**Industrial Estate**” means such estates, which the Board may, by notification in the Official Gazette,

- specify in accordance with the scheme framed and notified by the Central Government;
- (iii) “**Industrial Growth Centre**” means such centres, which the Board, may, by notification in the Official Gazette, specify in accordance with the scheme framed and notified by the Central Government;
 - (iv) “**Industrial Park**” means such parks, which the Board, may by notification in the Official Gazette, specify in accordance with the scheme framed and notified by the Central Government;
 - (v) “**initial assessment year**” means the assessment year relevant to the previous year in which the undertaking or the enterprise begins to manufacture or produce articles or things, or commences operation or completes substantial expansion;
 - (vi) “**Integrated Infrastructure Development Centre**” means such centres, which the Board, may, by notification in the Official Gazette, specify in accordance with the scheme framed and notified by the Central Government;
 - (vii) “**North-Eastern States**” means the States of Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland and Tripura;
 - (viii) “**Software Technology Park**” means any park set up in accordance with the Software Technology Park scheme notified by the Government of India in the Ministry of Commerce and Industry;
 - (ix) “**substantial expansion**” means increase in the investment in the plant and machinery by at least fifty per cent of the book value of plant and machinery (before taking depreciation in any year), as on the first day of the previous year in which the substantial expansion is undertaken;
 - (x) “**Theme Park**” means such parks, which the Board, may, by notification in the Official Gazette, specify in accordance with the scheme framed and notified by the Central Government.

DEDUCTION IN RESPECT OF PROFITS AND GAINS FROM THE BUSINESS OF COLLECTING AND PROCESSING BIO-DEGRADABLE WASTE (SECTION 80-JJA)

The section provide that where the gross total income of an assessee includes any profits and gains derived from the business of collecting and processing or treating of bio-degradable waste for generating power, or producing bio-fertilizers, bio-pesticides or other biological agents or for producing bio-gas, making pellets or briquette for fuel or organic manure.

Amount of Deduction:

There shall be allowed in computing the total income of the assessee, a deduction of an amount equal to the whole of such profit and gains for a period of five consecutive assessment years beginning with the assessment year relevant to the previous year in which such business commences.

DEDUCTION IN RESPECT OF EMPLOYMENT OF NEW WORKMEN (SECTION 80-JJAA)

In order to encourage the employers to further generate more employment opportunities, a new Section 80JJAA has been inserted by Finance (No. 2) Act, 1998 w.e.f. assessment year 1999-2000:

- the assessee should be an Indian Company;
- its gross total income should include profits and gains derived from manufacture of goods in a factory;
- the factories should not be hived off or transformed or acquired by the assessee company as a result of amalgamation with another company;
- the assessee furnishes alongwith the return of income a report of an accountant in form No. 10DA;

Amount of Deduction:

If the aforementioned conditions are satisfied the assessee shall be allowed a deduction of an **amount equal to 30% of additional wages** paid to the new regular workmen employed by the assessee in the previous year for three assessment years including the assessment year relevant to the previous year in which such employment is provided.

Additional wages means the wages paid to new regular workman in excess of 100 workmen employed during the previous year.

However in case of an existing factory additional wages shall be nil if the increase in the number of regular workmen employed during the year is less than 10% of the existing number of workmen employed in such factory as on the last day of the preceding year.

Note: The word 'Factory' shall have the same meaning assigned to it in clause (m) of section 2 of the Factories Act, 1948.

Regular workmen does not include:

- (a) a casual workman
- (b) a workman employed through contract labour
- (c) any other workman employed for a period less than 300 days during the previous year.

DEDUCTION IN RESPECT OF CERTAIN INCOMES OF OFFSHORE BANKING UNITS (SECTION 80LA)

(1) Where the gross total income of an assessee, –

- (i) being a scheduled bank, or any bank incorporated by or under the laws of a country outside India,

(ii) Quantam of deduction:

Owning an offshore banking unit in a special economic zone, includes any income referred to in Sub-section (2), there shall be allowed, in accordance with and subject to the provisions of this section, a deduction from such income, of an amount equal to –

- (a) 100% of such income for five consecutive assessment years beginning with the assessment year relevant to the previous year in which the permission, under Clause (a) of Sub-section (1) of Section 23 of the Banking Regulation Act, 1949 (10 of 1949), was obtained, and thereafter;

- (b) 50% of such income for next five consecutive assessment years.

(2) Income in respect of which deduction is allowed: The income referred to in Sub-section (1) shall be the income –

- (a) from an offshore banking unit in a special economic zone;
- (b) from the business, referred to in Sub-section (1) of Section 6 of the Banking Regulation Act, 1949 (10 of 1949), with an undertaking located in a special economic zone or any other undertaking which develops, develops and operates or operates and maintains a special economic zone;
- (c) received in convertible foreign exchange, in accordance with the regulations made under the Foreign Exchange Management Act, 1999 (42 of 1999).

(3) Conditions to be satisfied: No deduction under this section shall be allowed unless the assessee furnishes along with the return of income, –

- (i) in the prescribed form (Form No. 10CCF), i.e., the report of a accountant as defined in the Explanation

below Sub-section (2) of Section 288, certifying that the deduction has been correctly claimed in accordance with the provisions of this section; and

- (ii) a copy of the permission obtained under Clause (a) of Sub-section (1) of Section 23 of the Banking Regulation Act, 1949 (10 of 1949), in case of a offshore Banking Unit.

Explanation. – For the purposes of this section, –

- (a) “**convertible foreign exchange**” shall have the same meaning assigned to it in clause (a) of the Explanation below Sub-section (4C) of Section 80HHC;
- (b) “**Offshore Banking Unit**” means a branch of a bank in India located in the special economic zone and has obtained the permission under Clause (a) of Sub-section (1) of Section 23 of the Banking Regulation Act, 1949 (10 of 1949);
- (c) “**scheduled bank**” shall have the same meaning assigned to it in Clause (e) of Section 2 of the Reserve Bank of India Act, 1934 (2 of 1934);
- (d) “**special economic zone**” shall have the same meaning assigned to it in Clause (viii) of the Explanation 2 to Section 10A.”

DEDUCTION IN RESPECT OF INCOME OF CO-OPERATIVE SOCIETIES (SECTION 80P)

The deduction is allowable in respect of following incomes, which are included in gross total income of co-operative societies:

- A. 100% of the profits of a primary society engaged in supplying milk, oilseeds, fruits or vegetables raised or grown by its members to
 - The government or a local authority; or
 - A government company or a statutory corporation; or
 - A federal co-operative society, engaged in the business of supplying the above-said products.
- B. 100% of the profits of co-operative society engaged in any one of the following activities:
 - Carrying on the business of banking or providing credit facilities to its member, or
 - A cottage industry, or
 - The marketing of agricultural produce grown by its members, or
 - The purchase of agricultural implements for the purpose of supplying them to its members, or
 - The processing, without the aid of power, of agricultural produce of its members, or
 - The collective disposal of the labour of its member, or
 - Fishing or allied activities for the purpose of supplying them to its members.

Provided, in the case of last two types of co-operative societies, the deduction, is available subject to the condition that the rules and bye-laws of the society restrict the voting rights to the members like, State Government, Co-operative Credit Society which provide financial assistance to the society and individual, who contributes their labours.

W.e.f. Assessment Year 2007-08 this exemption is not be available to co-operative banks other than a primary agricultural credit society or a primary co-operative agricultural and rural development bank.

- C. Profits and gains of co-operative society other than those specified in A and B above is exempt up to the specified limits:

- is case of a consumer co-operative society – ₹ 1,00,000
 - is any other case – ₹ 50,000
- D. All profits by way of interest or dividend from its investment with any other co-operative society.
- E. 100% of income or profit of a Co-operative Society from the letting of godowns or warehouse for storage, processing or facilitating the marketing of commodities.
- F. A co-operative society, not being a housing society or an urban consumers society or a society carrying on transport business or a society engaged in the performance of any manufacturing operation with the aid of power, where the gross total income does not exceed ₹ 20,000. The amount of any income by way of interest on securities or any income from house property chargeable under Section 22 will also be allowed as deduction.

DEDUCTION IN RESPECT OF ROYALTY INCOME, ETC., OF AUTHORS OF CERTAIN BOOKS OTHER THAN TEXT BOOKS (SECTION 80QQB)

No deduction under this section shall be allowed unless an assessee furnishes a certificate in the prescribed form 10CCD/10H.

Where in case of an assessee, being an individual, who is

- Resident in India
- an author of a book other than textbooks
- income must be derived from such profession
- income must be either lump sum consideration or royalty copyright fees.

Amount of deduction:

His gross total income of the previous year includes royalty or the copyright fees, there shall, in accordance with and subject to the provisions of this section, be allowed a **deduction of 100% of such income or Rs. 300,000, whichever is less.**

Further, where income by way of such royalty or copyright fees is not a lump sum consideration in lieu of all rights of the assessee is the book, than such royalty, etc. before allowing expenses, in excess of 15% of the value of such books sold during the previous year, shall be ignored.

Provided further that in respect of any income earned from any sources outside India, so much of the income, shall be taken into account for the purpose of this section as is brought into India by, or on behalf of, the assessee in convertible foreign exchanges within the period of six months from the end of the previous year in which such income is earned or within such further period as the competent authority may allow in this behalf.

Certificates to be furnished:

(a) No deduction under this section shall be allowed unless the assessee furnishes a certificate in the prescribed form (form No. 10CCD) duly signed by the prescribed authority, along with the return of income setting forth such particulars as may be prescribed.

(b) No deduction under this section shall be allowed in respect of any income earned from any sources outside India, unless the assessee furnishes a certificate in the prescribed form (form No. 10H) from prescribed authority, as may be prescribed, along with the return of income.

No double deduction: Where a deduction for any previous year has been claimed and allowed in respect of any income referred to in this section, no deduction in respect of such income shall be allowed, under any other provision of the Act in any assessment year.

DEDUCTION IN RESPECT OF ROYALTY ON PATENTS (SECTION 80RRB)

(1) Where in the case of an assessee, being an individual, who is –

- (a) resident in India;
- (b) a patentee;
- (c) in receipt of any income by way of royalty in respect of a patent registered on or after the 1st day of April, 2003 under the Patents Act, 1970, and

his gross total income of the previous year includes royalty, there shall, in accordance with and subject to the provisions of this section, **be allowed a deduction of 100% of such income or ₹ 300,000, whichever is less.**

Provided that where a compulsory licence is granted in respect of any patent under the Patent Act, 1970, the income by way of royalty for the purpose of allowing deduction under this section shall not exceed the amount of royalty under the terms and conditions of a licence settled by the Controller under that Act:

Provided further that in respect of any income earned from any sources outside India, so much of the income, shall be taken into account for the purpose of this section as is brought into India by, or on behalf of, the assessee in convertible foreign exchange within a period of six months from the end of the previous year in which such income is earned or within such further period as the competent authority may allow in this behalf.

(2) Certificates to be furnished:

(a) No deduction under this section shall be allowed unless the assessee furnishes a certificate in the prescribed form (Form No. 10CCD), duly signed by the prescribed authority, along with the return of income setting forth such particulars as may be prescribed.

(b) No deduction under this section shall be allowed in respect of any income earned from any source outside India, unless the assessee furnishes a certificate in the prescribed form (Form No. 10H), from the authority or authorities, as may be prescribed, along with the return of income.

(3) No Double deduction: Where a deduction for any previous year has been claimed and allowed in respect of any income referred to in this section, no deduction in respect of such income shall be allowed, under any other provision of this Act in any assessment year.

Explanation. – For the purposes of this section, –

- (a) **“Controller”** shall have the meaning assigned to it in clause (b) of Sub-section (1) of Section 2 of the Patents Act, 1970;
- (b) **“lump sum”** includes an advance payment on account of such royalties which is not returnable;
- (c) **“patent”** means a patent (including a patent of addition) granted under the Patents Act, 1970;
- (d) **“patentee”** means the person, being the true and first inventor of the invention, whose name is entered on the patent register as the patentee, in accordance with the Patents Act, 1970, and includes every such person, being the true and first inventor of the invention, where more than one person is registered as patentee under that Act in respect of that patent;
- (e) **“patent of addition”** shall have the meaning assigned to it in clause (q) of Sub-section (1) of Section 2 of the Patents Act, 1970;
- (f) **“patented article”** and **“patented process”** shall have the meanings respectively assigned to them in clause (o) of Sub-section (1) of Section 2 of the Patents Act, 1970;
- (g) **“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 of the patented article for commercial use) for –

- (i) the transfer of all or any rights (including the granting of a licence) in respect of a patent; or
 - (ii) the imparting of any information concerning the working of, or the use of, a patent; or
 - (iii) the use of any patent; or
 - (iv) the rendering of any services in connection with the activities referred to in Sub-clauses (i) to (iii);
- (h) "true and first inventor" shall have the meaning assigned to it in Clause (y) of Sub-section (1) of Section 2 of the Patents Act, 1970.

DEDUCTION IN RESPECT OF INTEREST ON DEPOSITS IN SAVINGS ACCOUNT (SECTION 80TTA)

(1) Where the gross total income of an assessee, being an individual or a Hindu undivided family, includes any income by way of interest on deposits (not being time deposits) in a savings account with –

- (a) a banking company to which the Banking Regulation Act, 1949 (10 of 1949), applies (including any bank or banking institution referred to in section 51 of that Act);
- (b) a co-operative society engaged in carrying on the business of banking (including a co-operative land mortgage bank or a co-operative land development bank); or
- (c) a Post Office as defined in clause (k) of section 2 of the Indian Post Office Act, 1898 (6 of 1898), (there shall be allowed in computing the total income of the assessee, a deduction which shall not exceed ₹10,000).

(2) Where the income referred to in this section is derived from any deposit in a savings account held by, or on behalf of, a firm, an association of persons or a body of individuals, no deduction shall be allowed under this section in respect of such income in computing the total income of any partner of the firm or any member of the association or any individual of the body.

"Time deposits" means the deposits repayable on expiry of fixed periods.

DEDUCTION IN CASE OF A PERSON WITH DISABILITY (SECTION 80U)

(1) Amount of deduction:

In computing the total income of an individual, being a resident, who, at any time during the previous year, is certified by the medical authority to be

- a person with disability, there shall be allowed a deduction of a sum of ₹ 50,000; or
- a person with severe disability shall be allowed a deduction of a sum of ₹ 1,00,000.

(2) Every individual claiming a deduction under this section shall furnish a copy of the certificate issued by the medical authority in the form and manner, as may be prescribed, along with the return of income under Section 139, in respect of the assessment year for which the deduction is claimed:

Provided that where the condition of disability requires reassessment of its extent after a period stipulated in the aforesaid certificate, no deduction under this section shall be allowed for any assessment year relating to any previous year beginning after the expiry of the previous year during which the aforesaid certificate of disability had expired, unless a new certificate is obtained from the medical authority in the form and manner, as may be prescribed, and a copy thereof is furnished along with the return of income under Section 139.

Explanation. – For the purposes of this section, –

- (a) “**disability**” shall have the meaning assigned to it in clause (i) of Section 2 of the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995 and includes “autism”, “cerebral palsy” and “multiple disabilities” referred to in clauses (a), (c) and (h) of Section 2 of the National Trust for Welfare of Persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities Act, 1999;
- (b) “**medical authority**” means the medical authority as referred to in clause (p) of Section 2 of the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995, or such other medical authority as may, by notification, be specified by the Central Government for certifying “autism”, “cerebral palsy”, “multiple disabilities”, “person with disability” and “severe disability” referred to in clauses (a), (c), (h), (q) and (o) of Section 2 of the National Trust for Welfare of Persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities Act, 1999;
- (c) “**person with disability**” means a person referred to in clause (t) of Section 2 of the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995, or clause (j) of Section 2 of the National Trust for Welfare of Persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities Act, 1999;
- (d) “**Person with severe disability**” means:
 - (i) a person with eighty per cent or more of one or more disabilities, as referred to in Sub-section (4) of Section 56 of the Persons with Disabilities (Equal Opportunities, Protection of Rights and Full Participation) Act, 1995; or
 - (ii) a person with severe disability referred to in clause (o) of Section 2 of the National Trust for Welfare of Persons with Autism, Cerebral Palsy, Mental Retardation and Multiple Disabilities Act, 1999.

RELIEF AND REBATE IN RESPECT OF INCOME-TAX

In addition to the provisions for aggregation discussed earlier, Section 66 lays down that in computing the total income of any assessee, there shall be included certain items of income on which no income-tax is payable under Chapter VII. Accordingly the provisions of Section 86 would be applicable.

SHARE OF MEMBER OF AN ASSOCIATION OF PERSONS OR BODY OF INDIVIDUALS IN THE INCOME OF THE ASSOCIATION OR BODY (SECTION 86)

This section as substituted by the Finance Act, 1992 with effect from the assessment year 1993-94 provides that no income tax shall be payable by the assessee who is a member of an association of persons or body of individuals (other than, a company or a co-operative society or a society registered under the Societies Registration Act, 1860 or under any law corresponding to that Act in force in any part of India) in respect of his share in the income of such association or body computed in the manner provided in Section 67A of the Act.

Further, where the association or body is chargeable to tax at the maximum marginal rate or any higher rate under any of the provisions of this Act, the share of a member computed as aforesaid shall not be included in his total income. However, in any other case, the share of a member shall form part of his total income.

It is also provided that where no income-tax is chargeable on the total income of the association or body. The share of a member computed as aforesaid shall be chargeable to tax as part of his total income and nothing contained in this section shall apply to the case.

INCOME FROM AN ASSOCIATION OF PERSONS OR A BODY OF INDIVIDUALS (SECTION 86)

Where the assessee is a member of an association of persons or body of individuals other than a company or a co-operative society or a society registered under the Societies Registration Act, 1860 or under any law corresponding

to that Act in force in any part of India), income-tax shall not be payable by the assessee in respect of his share in the income of the association or body computed in the manner provided in Section 67A that –

- (a) where the association or body is chargeable to tax on its total income at the maximum marginal rate or any higher rate, under any of the provisions of this Act, the shares of a member computed as aforesaid shall not be included in his total income;
- (b) in any other case, the share of a member computed as aforesaid shall form part of his total income;

Provided further that where no income-tax is chargeable on the total income of the association or body, the share of a member computed as aforesaid shall be chargeable to tax as part of his total income and nothing contained in this section apply to the case.

REBATE OF INCOME-TAX IN CASE OF CERTAIN INDIVIDUALS (SECTION 87A)

An assessee, being an individual resident in India, whose total income does not exceed 5 lakh rupees, shall be entitled to a deduction, from the amount of income-tax on his total income with which he is chargeable for any assessment year, of an amount equal to 100% of such income tax or an amount of 2,000 rupees, whichever is less.

In simple words, with a view to provide tax relief to the individual tax payers who are in lower income bracket, rebate from the tax payable by an assessee is provided to an individual, resident in India, whose total income does not exceed five lakh rupees.

The rebate shall be equal to the amount of income-tax payable on the total income for any assessment year or an amount of 2,000 rupees, whichever is less.

Consequently any individual having income up to ₹ 2,20,000 will not be required to pay any tax and every individual having total income above ₹ 2,20,000/- but not exceeding ₹ 5,00,000/- shall get a tax relief of ₹ 2000/-.

RELIEF WHEN SALARY IS PAID IN ARREARS OR IN ADVANCE [SECTION 89]

It has been explained earlier that arrears and advances of salary are assessed in the hands of the employee in the year they are received. Consequently, in a financial year, an employee may become chargeable to tax in respect of salary for more than twelve months. Likewise, any payment in the nature of profit in lieu of salary

[Section 17(3)] is also chargeable in the year of receipt or the year when it became due in addition to the normal salary received by him. In consequence the income swells and the average rate of tax too. In order to remove this hardship, the Assessing Officer has been empowered to grant relief in appropriate cases in accordance with Rule 21AA of the Income-tax Rules, 1962.

Provided that no such relief shall be granted in respect of any amount received or receivable by an assessee on his voluntary retirement or termination of his service, in accordance with any scheme or schemes of voluntary retirement or in the case of a public sector company referred to in subclause (i) of clause (10C) of section 10, a scheme of voluntary separation, if an exemption in respect of any amount received or receivable on such voluntary retirement or termination of his service or voluntary separation has been claimed by the assessee under clause (10C) of section 10 in respect of such, or any other, assessment year.

RELIEF UNDER SECTION 89 IS PROVIDED IN THE FOLLOWING CASES:

- in respect of salary received in advance or in arrears;
- in respect of arrears of family pension;
- in respect of gratuity;
- in respect of compensation on termination of employment;
- in respect of commutation of pension;
- in respect of other payment.

Illustration

Mr. Ram who is a person with disability submit the following information. Compute (a) the Taxable Income (b) the Tax Payable for the assessment year 2014-2015.

	₹
(i) Salary (per annum)	3,00,000
(ii) Rent received	48,000
(iii) Dividend from Co-operative Society	1,000
(iv) Interest on Savings Bank Deposits	18,000
(v) Interest on Government securities	1,000
(vi) Winning from Lotteries (gross)	5,000
(vii) NSC (VIII Issue) purchased during the year	10,000
(viii) Deposit under PPF Scheme	30,000

He earned a long-term capital gain of ₹ 15,000 on sale of gold during the year.

Solution**(A) Computation of Total Income**

	₹	₹
<i>Income from salary</i>		
Basic Salary	3,00,000	
Less: Deduction under section 16	<u>Nil</u>	3,00,000
<i>Income from house property</i>		
Rent Received	48,000	
Less: Statutory Deduction @ 30%	<u>14,400</u>	33,600
<i>Capital Gains</i>		
Long-term capital gains		15,000
<i>Income from other sources</i>		
Dividend from co-operative society	1,000	
Interest on saving bank deposits	18,000	
Interest on Government Securities	1,000	
Winning from Lotteries	<u>5,000</u>	<u>25,000</u>
Gross Total Income		<u>3,73,600</u>
Less: Deduction under section 80C to 80U		
(i) Under section 80C ₹(10,000 + 30,000)	40,000	
(ii) Under section 80TTA	10,000	
(iii) Under section 80U	<u>50,000</u>	<u>1,00,000</u>
Total Income		<u>2,73,600</u>

(B) Computation of tax on Total Income

(i) Tax on winning from lotteries (30% of ₹ 5,000)	1,500
(ii) Tax on long-term capital gains (20% of ₹ 15,000)	3,000

(iii) Balance of Total Income ₹ 2,53,600) (Refer Note Below)	<u>3,360</u>
Tax Payable	7,860
Add: Education Cess & SHEC – @ 3%	<u>236</u>
Tax rounded off	<u>8.100</u>

Note : Tax @ 10% (2,53,600 – 2,00,000) = ₹ 5,360

Less: Rebate under section 87A of ₹ 2000 or 100% of tax amount whichever is lower (5,360 – 2000)

Hence, ₹ 2,000 shall be allowed as rebate i.e. ₹ 3,360

Illustration

Rahul who is a resident in India, is a person with disability. He provides the following particulars of his income for the year ended 31.3.2014.

	₹
(a) Salary for working as a cable operator (per month)	18,000
(b) Interest on government securities (gross)	45,000
(c) Dividend from Indian Company	5,000
(d) Honorarium from school of orphanage for giving his service	49,000

He has donated ₹ 20,000 to the school for orphanage which is approved as a charitable institution and contributed ₹ 2,000 to Prime Minister National Relief Fund. He has also paid ₹ 3,000 by credit card as premium of mediclaim policy. His father is also a person with disability and is dependent on him for medical treatment and rehabilitation. Rahul spends ₹ 8,000 during the year on him.

Compute the Total Income for the Assessment Year 2014-15, assuming he has deposited ₹ 20,000 in Public Provident Fund Account.

Solution

Computation of Total Income for the Assessment Year 2014-15

<i>Income from salary</i>	₹	₹
Gross Salary	2,16,000	
Less: Deduction	<u>Nil</u>	2,16,000
<i>Income from other sources</i>		
Interest on Government Securities	45,000	
Dividend from Indian Company	Exempt	
Honorarium	<u>49,000</u>	<u>99,000</u>
Gross Total Income		<u>3,15,000</u>
<i>Less: Deductions :</i>		
(i) Under section 80C	20,000	
(ii) Under section 80D	3,000	
(iii) Under section 80DD	50,000	
(iv) Under section 80U	50,000	
(v) Under section 80G		
– Prime Minister Relief Fund (100% of ₹ 2,000)	2,000	
– Orphanage School (50% of ₹ 19,200)	<u>9,600</u>	<u>11,600</u>
i.e. 10% of 1,92,000 ₹ (3,15,000 – 1,23,000)		1,34,600
Total Income		<u>1,80,400</u>

LESSON ROUND UP

- **Section 80C:** Deduction on life insurance premia, contribution to provident fund, etc - Available to individual/HUF for a maximum amount of ₹ 1,00,000.
- **Section 80CCC:** Deduction for contribution to pension fund - Available to individual for maximum amount of ₹ 100,000.
- **Section 80CCD:** Deduction in respect of contribution to pension scheme of Central Government- available to individual.
- **Section 80CCE:** Limit on deductions under Sections 80C, 80CCC and 80CCD - can not exceed ₹ 1,00,000.
- **Section 80CCG:** Deduction in respect of investment made under any equity saving scheme : Available to resident individual subject to maximum of ₹25,000.
- **Section 80D:** Deduction in respect of medical insurance premia - Available to individual/HUF.
- **Section 80DD:** Deduction in respect of maintenance including medical treatment of a dependant who is a person with disability – Available to resident individual/HUF for a fixed amount of ₹50,000 and ₹1,00,000.
- **Section 80DDB** read with
 - Rule 11DD:** Deduction in respect of medical treatment, etc.: Available to Resident individual/resident HUF for maximum of ₹60,000.
- **Section 80E:** Deduction in respect of repayment of loan taken for higher education: Available to individual.
- **Section 80G:** Deduction in respect of donations to certain funds, charitable institutions, etc. Available to all assessees subject to maximum of 50% of qualifying amount, 100% as the case may be.
- **Section 80GG:** Deduction in respect of rent paid Available to individual for a maximum of ₹24,000.
- **Section 80GGA:** Deduction in respect of certain donations for scientific research or rural development
- **Section 80GGB:** Deduction in respect of contributions given by companies to political parties
- **Section 80GGC:** Deduction in respect of contributions given by any person to political parties
- **Section 80-IA:** Deduction in respect of profits and gains from industrial undertakings or enterprise engaged in infrastructure development
- **Section 80-IAB:** Deduction in respect of profit and gains by an undertaking a enterprise engaged in development of Special Economic Zone
- **Section 80-IB:** Deduction in respect of profits and gains from certain industrial undertakings other than infrastructure development undertakings
- **Section 80-IC:** Special provisions in respect of certain undertakings or enterprises in certain special category States
- **Section 80-JJA:** Deduction in respect of profits and gains from the business of collecting and processing bio-degradable waste – Available to all assessees carrying on the business of collecting and processing bio-degradable waste.

- **Section 80-JJAA:** Deduction in respect of employment of new workmen – Available to Indian company of 30% of additional wages paid to new regular workmen.
- **Section 80LA:** Deduction in respect of certain incomes of Offshore Banking Units – 100% of certain income for 5 years, 50% of such income for 5 years.
- **Section 80P:** Deduction in respect of income of co-operative societies - Specified incomes subject to amount specified in sub section (2).
- **Section 80QQB:** Deduction in respect of royalty income, etc., of authors of certain books other than text books – Available to resident individual, for a maximum deduction of ₹3,00,000.
- **Section 80RRB:** Deduction in respect of royalty on patents – Available to Resident Individual, maximum of ₹3,00,000.
- **Section 80TTA:** Deduction in respect of interest on deposits in savings account – Available to Individual/ HUF upto ₹10,000.
- **Section 80U:** Deduction in case of a person with disability – Available to Resident individual subject to maximum of ₹100,000

SELF TEST QUESTIONS

These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation.

MULTIPLE CHOICE QUESTIONS

- (1) Deduction under section 80C can be claimed for fixed deposit made in any scheduled bank, if the minimum period of deposit is –
 - (a) 5 years
 - (b) 8 years
 - (c) 10 years
 - (d) 12 years.
- (2) Deduction available to an individual in respect of maintenance including medical treatment of a dependent being a person with 80% disability, when amount incurred in this respect is ₹ 40,000 will be —
 - (a) ₹ 40,000
 - (b) ₹ 50,000
 - (c) ₹ 1,00,000
 - (d) None of the above.
- (3) Which of the following is covered under section 80D of the Income Tax Act, 1961 –
 - (a) Repayment of loan taken for higher education
 - (b) Medical treatment of handicapped dependent
 - (c) Medical Insurance Premium
 - (d) Reimbursement of medical expenses
- (4) Maximum qualifying limit for deduction under section 80C is –
 - (a) ₹ 50,000
 - (b) ₹ 1,10,000

- (c) ₹ 1,00,000
 (d) ₹ 1,50,000

FILL IN THE BLANKS

1. Deduction available under section 80QQB in respect of royalty income of authors shall not exceed ₹ _____ in a previous year.
2. Deduction available under section 80GG towards rent paid shall not exceed ₹ _____ per month.
3. The amount of deduction under section 80DD in respect of maintenance including medical treatment of a dependent with 60% disability will be ₹ _____ when no amount is actually spent on treatment by the resident assessee and the handicapped person does not claim any deduction under section 80U.
4. For the purpose of full-time education, only tuition fees of _____ per child upto 2 children are allowed as deduction under section 80C.

ELABORATIVE

1. Enumerate the various deductions allowable to individuals from their total income in respect of their incomes and payments.
2. Enumerate the various rebates and reliefs available to individuals under the Income-tax Act, 1961.
3. What are the different kinds of incomes which are included in the total income but on which no income-tax is payable?
4. What conditions are to be satisfied in order to claim a deduction for donations made to certain funds or/ and charitable institutions? Illustrate.
5. Write a short note on the relief available under Section 89.
6. Explain in brief the deduction for the medical insurance premium paid by the assessee.

PRACTICAL QUESTIONS

1. Aakash, aged 40 years, has following incomes for the previous year 2013-14. You are required to ascertain his taxable income:

	₹
Income from salary	2,10,000
Profit from business	1,50,000
Actual rent of house property	1,80,000
Municipal tax paid being 10% of municipal value	20,000
Agricultural income	1,20,000
Long-term capital gain on sale of plot	15,000
Winning from lottery (gross)	5,00,000
LIC premium paid	20,000
Contribution to public provident fund	50,000
Interest on fixed deposit in a bank	30,000

2. From the following information, compute the total income of Anurag for the assessment year 2014-15.

Income from salary	2,80,000
Income from House Property	40,000
Business Loss	(-) 1,90,000
Loss from a specified business referred to under section 35AD	(-) 60,000
Short-term capital loss	(-) 60,000
Long-term capital gains	2,40,000
Tution fees	1,20,000

ANSWERS/HINTS

Multiple Choice Question

1 (a) ; 2 (c); 3 (c) ; 4 (c)

Fill In The Blanks

1. ₹ 3,00,000; 2. ₹ 2000 pm ; 3. ₹ 50,000 ; 4. Any amount upto ₹1,00,000

Practical Questions

1. ₹ 9,61,000; 2. ₹. 1,80,000;

Test Your Knowledge

1. (d) 2. (c) and (d) 3. (a) and (b)

SUGGESTED READINGS

- | | | |
|--------------------------------|---|---|
| 1. Dr. V.K. Singhania | : | Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi. |
| 2. Girish Ahuja and Ravi Gupta | : | Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi. |

Lesson 7

Computation of Tax Liability of Hindu Undivided Family / Firm / Association of Persons / Co-operative Societies

LESSON OUTLINE

- Taxation of Hindu Undivided Families
- Computation of Income of the H.U.F.
- Partition of a Hindu undivided family (Section 171)
- Assessment after partition (Section 171)
- Partition of the HUF can be total or partial
- Taxation of Firms
 - (1) Scheme of taxation of a firm and its partners
 - (2) Change in Constitution of a Firm (Section 187)
 - (3) Losses of Registered Firms (Section 75)
 - (4) Assessment of Partners
 - (5) Succession of one firm by another firm (Section 188)
 - (6) Special provisions relating to Retail Trade
 - (7) Alternate Minimum Tax on all persons other than corporates
 - (8) Illustrations
- Taxation of Association of Persons
 - (1) Meaning
 - (2) Formation of an Association of Persons
 - (3) Tax Liability of an Association of Persons
 - (4) Method of Computing Share of a Member of Association of Persons, etc. (Section 67A)
 - (5) Assessment in case of Dissolution of an Association of Persons (Section 177)
- Taxation of Co-Operative Societies
 - (1) Meaning [Section 2(10)]
 - (2) Computation of Income of Co-operative Societies
 - (3) Assessment of Co-operative Societies
 - (4) Rates of Income-tax
 - (5) Illustrations
- Tonnage Tax Scheme [Sections 115V to 115VZC] (w.e.f. Assessment Year 2005-06)
- Lesson Round Up
- Self Test Questions

LEARNING OBJECTIVES

In this lesson the Income Tax Treatment with relation to Hindu Undivided Families (HUF), Firms, Associations of Persons and Cooperative Societies is being discussed. The tax implications, rates of tax and other issues relating to the above persons have been discussed elaborately. Hindu undivided family is treated as a separate taxable entity for the purpose of income tax assessment. With regard to firms the focus is on partnership firms or Limited liability partnerships.

At the end of this lesson, you will learn

- What is a HUF, how it comes into existence
- When and how it can be partitioned and What are the tax implications before and after its partition.
- What is partnership firm
- What are the tax implications in the hands of partners and firm
- What are admissible expenses/inadmissible expenses while calculating the book profit of the firm.
- What are the provisions of Alternate Minimum Tax
- How Association of persons is formed
- What is the method of computation of share of a member of AOP.
- What are Co-operative Societies
- How the tax liability of Cooperative societies determined.
- What is Tonnage Tax scheme.

TAXATION OF HINDU UNDIVIDED FAMILIES

The term 'Hindu undivided family' has not been defined in the Income-tax Act. However, in general parlance it means an undivided family of Hindus. Creation of a HUF is a God-gifted phenomenon. As soon as a married Hindu gets a child, a new HUF comes into existence. It is not at all necessary that every HUF must have joint property or family income. [*R. Subramania Iyer v. CIT* (1955) 28, ITR, 352]. However, to become an assessee under the Income-tax Act, there must be 'income-yielding' joint property of the family.

A HUF may consist of a number of smaller HUFs. A smaller HUF has a legal existence and may be assessable as a unit distinct from the apex joint family even when the bigger HUF is in place [*CIT v. Khanna* (1963) 49 ITR 232].

Under Hindu Law, a Joint Hindu Family consists of all persons lineally descended from a common ancestor (except those who have separated from the joint family by partitioning of assets) and includes their wives and unmarried daughters, and also a stranger who has been adopted by the family. [*Surjit Lal Chhabra v. CIT* (1975) 101, ITR, p.776 (S.C.)].

The Supreme Court's decision in the case of *Surjit Lal Chhabra v. CIT* (1975 101 ITR 776) has come to stay as one of the leading case laws. The ratio laid down by the Supreme Court had been applied by the Andhra Pradesh, Orissa and Madras High Courts, followed by Bombay, Patna, Madhya Pradesh and Delhi High Courts and relied upon by the Punjab High Court. In the latest case, the Delhi High Court held in *Commissioner of Income-tax v. S.P. Chopra* (1991, 191 ITR 455) that the income from the half share of the property had to be treated as the individual income of the assessee under the personal law and not as income of the family. The character of the property had to be determined in accordance with the personal law of the assessee and not on the basis of how the property had been treated by the revenue in respect of earlier assessments.

A son conceived or in his mother's womb is equal in many respects to a son actually in existence, viz., inheritance, partition, survivorship etc. But this doctrine does not apply to the Income-tax Act. Hence, a son conceived is not treated a member of the H.U.F. for Income-tax purposes. [*T.S. Srinivasan v. C.I.T.*, (1966) 60, ITR, p.36 (S.C.)].

Jain and Sikh undivided families are also treated as Hindu undivided families unless, under special circumstances, the assessee claims not to be treated as such. If such claim is made, the assessee shall have to prove that there is some such custom in his family on account of which it cannot be treated as a Hindu undivided family.

A Hindu does not cease to be a Hindu merely because he declared for the purpose of the Special Marriage Act, 1872, that he does not profess Hindu Religion. Such a Hindu does form an H.U.F. with his children from such marriage. [*CIT v. Partap Chand* (1959), 36 ITR, 262]. Similarly, a Muslim family governed by the Marumakkathayam law constitutes 'Tarwad' or 'Thavazhi' and falls within the definition of a H.U.F. [*V.K.P. Abdul Kadar Haji v. Ag. ITO* (1967) 66, ITR, 173].

If a Hindu gets converted as a Christian, the family of such a person will not be a HUF. However a Hindu, along with his son (by a Christian wife) who has been brought up as a Hindu will be a HUF. [*CWT v. R. Sridharan* (1976) 104, ITR, 436 (S.C.)].

A Hindu Joint Family consists of two types of members:

(i) Coparceners: The lineal male descendants of a person upto the third generation of such person are known as coparceners. The coparceners acquire, on birth, ownership in the ancestral properties of such ascendant and have a right to claim partition of such property at any time. However, w.e.f. 9.9.2005 due to amendment of Hindu Succession Act, the daughter of a coparcener shall by birth become a coparcener in her own right in the same manner as the son. Hence, the daughter can also ask for partition.

(ii) Other members: Such members include wives of male members of the family and other male members.

Thus, a Hindu Joint Family may consist of:

- (a) All persons lineally descended from a common ancestor and includes their wives and daughters (w.e.f. 9.9.2005).
- (b) A male and widow or widows of deceased male member or members. [*Gowli Buddanna v. C.I.T.* (1966) 60, ITR, p. 293 (S.C.)]

However, an unmarried coparcener who receives share on the partition of joint family properties, cannot form a Hindu undivided family unless he marries. After his marriage, he can hold the property received from family as joint family property consisting of himself and his wife. [*C. Krishna Prasad v. C.I.T.* (1974) 97, p. 493 (S.C.)].

Karta: Property of the family is ordinarily managed by the father or other senior member for the time being of the family. He is called Karta. However, the senior member may give up his right of management and a junior member may be appointed as Karta with the consent of all other members. [*Narendra Kumar J. Modi v. CIT* (1976) 105, ITR, 109 (S.C.)]. In the absence of a male member in the family or when all male members are minors, a woman member can be treated as manager of the family for income-tax purposes. [*Smt. Champa Kumari Singhi v. Addl. Member of the Board of Revenue* (1962) 46, ITR, p. 81].

Since daughter is also a coparcener w.e.f. 9.9.05, it may be presumed that daughter can also be karta of her fathers HUF.

Joint Property of the family:

It consists of:

- (i) ancestral property;
- (ii) accretion thereto;
- (iii) acquisition with joint funds; and
- (iv) self-acquired property of any member thrown by him into the common stock to be treated as family property. In the case of *Pushpa Devi v. C.I.T.* the Supreme Court has held that a Hindu female, not being a coparcener, cannot blend her separate property with Joint family property. However, she can make a gift of her property to the family. [(1977) 109, ITR p. 730].

The Supreme Court's decision in the case of *Pushpa Devi v. Commissioner of Income-tax* (1977, 109 ITR 730) had been later followed by the Calcutta, Andhra Pradesh and Madras High Courts. In the latest case, the Madras High Court held in the case of *Rajathy Ammal v. Commissioner of Wealth-tax* (1987, 164 ITR 605) that a female member could not throw her property into the family hotchpotch and the only way she could achieve her purpose was either by gifting it or selling to the family.

Further, Section 64(2) provides that where an individual being a member of Hindu undivided family transfers his separate property after 31st December, 1969 to the family for the common benefit of the family, otherwise than for adequate consideration, such property is known as converted property. The income derived from the converted property or any part thereof shall be included in the total income of the transferor individual and not in the income of the family.

School of Hindu Law: According to Hindu Law, HUFs are governed by two schools viz. **Mitakshara and Dayabhaga.**

Mitakshara School applies to whole of India except the states of West Bengal and Assam.

Dayabhaga school applies to the States of West Bengal and Assam. The difference between the two schools is as under:

- (i) **Foundation:** In the Mitakshara School, the foundation of a coparcenary is laid down when a son is

born to the Mitakshara father. Under the Dayabhaga school the foundation of a coparcenary is laid on the death of the father leaving, as survivors, one or more sons.

- (ii) **Right to partition:** A Mitakshara son, in whom the interest in family property is vested by birth, all along possesses a right to demand partition. A Dayabhaga son, on the other hand acquires no interest in the family property by birth and, consequently, has no right to demand partition of the HUF property from his father.
- (iii) **Quantum of share:** Under Mitakshara Law, each coparcener takes an undefined share in the coparcenary property. The share of the members decreases by birth in the family and increases upon death of a coparcener. A Dayabhaga coparcener, on the other hand, always takes a defined share in the property left by his deceased father. Thus, the heirs of a deceased governed by the Dayabhaga school do not constitute a HUF automatically on the death of the deceased and cannot be assessed as a HUF unless they have by mutual consent agreed to form a joint family.
- (iv) **Gift out of ancestral property:** A Mitakshara Karta may make a gift of movable property of the family, out of love and affection, within reasonable limits. He can also make a gift of immovable properties, within reasonable limits for pious purposes; i.e., for charitable and religious purposes or to a daughter in fulfilment of a nuptial promise etc. However, a gift to a stranger is void. On the contrary, a Dayabhaga father can alienate ancestral property, both movable as well as immovable, by sale, gift, will or otherwise in the same way as he can dispose of his separate property.

Position under Hindu Succession Act, 1956

This Act came into force on and from 17th June, 1956. It lays down a uniform and comprehensive system of inheritance and applies to persons governed by the Mitakshara as well as the Dayabhaga Schools, superseding and abrogating all previous law or customs or usage having the force of law.

Under this Act, the heirs of a male Hindu dying intestate on or after 17th June, 1956 are divided into three classes. Class I heirs get the right to the deceased's property simultaneously to the exclusion of all other Classes of heirs. Class II relations succeed only if there is no class I relation and, the heirs in the first entry of class II being preferred to heirs in the second entry, and so on, but heirs in any one entry taking in equal shares amongst themselves.

The students should note that Section 4 of the Hindu Succession Act, 1956 clearly lays down that "save as otherwise expressly provided in the Act, any text, rule or interpretation of Hindu Law or any custom or usage as part of that law in force immediately before the commencement of the Act shall cease to have effect with respect to any matter for which provision is made in the Act." And, Section 8 of the Hindu Succession Act, 1956, lays down the scheme of succession to the property of a Hindu dying intestate. The schedule classifies the heirs on which such property shall devolve.

The preferential heirs of class I are as under:

(1) Son (2) Daughter (3) Widow (4) Mother (5) Son/daughter/widow of a predeceased son (6) son/daughter of a predeceased daughter (7) Son/daughter/ widow of a predeceased son of a predeceased son.

A son's son is not mentioned as an heir under Class I of the schedule and, therefore, he cannot get any right in the property of his grandfather under the provision. The right of a son's son in his grandfather's property during the lifetime of his father which existed under the Hindu Law as in force before the Act, is not saved expressly by the Act and, therefore the earlier interpretation of Hindu Law giving a right by birth in such property 'ceased to have effect'.

Therefore, the property which devolves on a Hindu on the death of his father intestate after coming into force of the Hindu Succession Act, 1956, does not constitute H.U.F. property consisting of his own branch including his sons. [Shri Vallabhdas Modani v. C.I.T. (1982) 138, ITR, p. 673].

The Allahabad High Court's decision supra in the case of *Shri Vallabhdas Modani v. Commissioner of Income-tax* was followed by the Andhra Pradesh High Court (1983, 144 ITR 18) and later approved by the Supreme Court in the case of *Commissioner of Wealth-Tax v. Chander Sen* (1986, 161 ITR 370) holding that it is not possible to say that when a son inherits the property in the situation contemplated by the Hindu Succession Act, 1956, he takes as Karta of his own undivided family.

Computation of Income of the H.U.F.

The gross total income of the family for the relevant previous year shall be computed under the relevant heads (as per the provisions of the Income-tax Act) as it is computed for other assessee. However, in this connection the following points are worth noting:

Clubbing of Income

- (i) If the funds of a Hindu Undivided family are invested in a company or a firm, fees or remuneration received by the member as a director, or a partner in the company or firm may be treated as income of the family in case the fees or remuneration is earned essentially as a result of investment of funds. But, if the fees or remuneration is earned essentially for services rendered by the member in his personal capacity, the income shall constitute the personal income of the member.
- (ii) For determining whether a particular income belongs to a member of the family or to his undivided family, the Supreme Court has enunciated certain principles. The question to be considered in such cases is, whether the remuneration received by the coparcener is in substance merely a mode of return made to the family because of the investment of the family funds in the business or whether it is a compensation for services rendered by the coparcener. If it is the former, it is an income of the HUF but if it is the latter it is the income of the individual. If the income was essentially earned as a result of the funds invested, the fact that a coparcener has rendered some service would not change the character of the receipt. But if, on the other hand, it is essentially a remuneration for the services rendered by the coparcener, the circumstances that his services were availed of because of the reason that he was a member of the family which had invested funds in that business or that he had obtained the qualification shares from out of the family funds would not make the receipt the income of the HUF. [*Raj Kumar Singh Hukam Chandji v. C/I/T* (1970) 78 ITR 33].

The Supreme Court's decision supra in the case of *Raj Kumar Singh Hukam Chandji v. Commissioner of Income-tax* has come to stay as one of the most followed/applied case laws. This decision had been followed by Patna (Full Bench), Allahabad, Bombay and Gujarat High Courts, applied by Andhra Pradesh, Madras, Kerala, Delhi, and Supreme Court itself. It would suffice to refer to the Supreme Court's decision in the case of *Y.L. Aggarwalla and others v. Commissioner of Income-tax* (1978, 114 ITR 471) holding that the share income was a return made to the family because of the investments of the family funds in the business and the share income was not the individual income of minor sons but was the income of the Hindu undivided family and had to be assessed in the hands of the family.

- (iii) Where a member of a HUF is a partner in a firm on behalf of the family and on partition of the property of the family, the share in the firm is allotted to such a member, subsequent to such allotment when the firm settles its accounts the whole income for that year would be the income of the individual member and no part of the income would be added to the income of the family. [*C/I/T v. Ashok Bhai Chiman Bhai* (1965) 56, ITR, 42 (S.C.)].
- (iv) The personal earning, including income from self acquired property of a member of the HUF, even though he has sons, would not be included in the income of the family. Such income shall be assessed as income of that individual. [*Kalyanji Vithal Das v. C/I/T* (1937) 5 ITR 90 (PC)].

- (v) Any sum paid by an HUF to a member of the family out of its income is not deductible in computing the income of the family. However, such amount will not be included in the income of such individual whether the family had paid tax on its income or not [Section 10(2)].
- (vi) If any remuneration is paid by the Hindu Undivided family to the karta or any other member for services rendered by him in conducting family's business, the remuneration is deductible if remuneration is (a) paid under a valid and bona fide agreement; (b) in the interest of, and expedient for, the business of family; and (c) genuine and not excessive. *Jugal Kishore Baldeo Sahai v. CIT* [1967] 63 ITR 238 (SC).
- (vii) If salary is paid by the Hindu undivided family to its karta for looking after its interest in firms in which it is partner through said karta, such salary is allowable as deduction - *CIT v. Prakash Chand Agarwal* [1982] 11 Taxman 55 (MP).
- (viii) Income from 'stridhan' is not includable in the income of the family. Property derived by a woman from her father or brother or husband or any other relative either before or after her marriage is known as 'stridhan'.
- (ix) If a member has converted or transferred without adequate consideration after December 31, 1969 his self-acquired property into joint family property, income from such property is not taxable in the hands of the family.
- (x) Income from immoveable estate is taxable in the hands of the holder of the estate and not in the hands of the Hindu undivided family. Though, the immoveable estate belongs to the family, income arising therefrom belongs to the holder of the estate who is the senior most male member of the family. Income from immoveable estate is taxable in the hands of the holder of the estate.
- (xi) Personal income of the members cannot be treated as income of Hindu undivided family.
- (xii) Under the Dayabhaga School of law, as stated in a preceding page, no son has any right in the ancestral property during the lifetime of his father. If, therefore, the father does not have any brother as a coparcener, income arising from ancestral property is taxable as his individual income.

Partition of a Hindu undivided family (Section 171)

'Partition' signifies division of property. In the cases of property capable of physical division, share of each member is determined by making physical division thereof. It must be noted that a division of income without physical division of property does not amount to partition. Where, however, the property is not capable of physical division, partition implies such division as the property may admit.

Who is entitled to share on partition

Though only coparceners can demand partition, once the partition takes effect, the following persons are entitled to a share:

- (a) all coparceners;
- (b) a son in the womb of his mother at the time of partition;
- (c) mother, who gets an equal share if the partition takes place among her sons after the death of her husband; and
- (d) wife, who gets a share equal to that of a son at the time of a partition between father and sons.

Assessment after partition (Section 171)

A joint family, once assessed as a HUF, continues to be assessed as such till one or more coparceners claim partition. Such claim must be made by the coparceners before the assessment of the income of the HUF for the

relevant assessment year is completed. On the receipt of such a claim, the Assessing Officer must make an inquiry after giving due notice to the members and record a finding whether there has been a partition and, if so, the date of the partition. The income of the family from the first day of the previous year to the date of partition is assessed as income of the HUF and from the next date of the partition to the date of close of the previous year, as the individual income of the recipient-members. If the recipient member forms another HUF along with his wife and son(s), the income of the property which was subject to partition is chargeable to tax in the hands of the new H.U.F.

A partition of the HUF can be both total and partial

Where the entire joint family property is divided among all coparceners and the family ceases to exist as an undivided family, the partition is total. A partial partition may be as regards: (a) the persons constituting the joint family, or (b) the properties belonging to the joint family, or (c) both. The device of partial partition has been used as a medium for reduction of proper tax liability. To curb such a practice, the Finance (No. 2) Act, 1980 inserted Sub-section 9 in Section 171 which lays down that partial partitions of HUFs effected after 31st Dec., 1978 will not be recognised for tax purposes.

The provisions made by Sub-section (9) in Section 171 are as follows:

- (i) In a case where a partial partition of a HUF has taken place after 31.12.1978, no claim of such partition will be enquired into and the Assessing Officer will not record a finding as to whether there has been a partition of the family property. Further, any finding regarding partial partition recorded under Section 171(3) will be null and void and of no legal effect.
- (ii) Such family will continue to be assessed as if no such partial partition has taken place, i.e., the property or source of income will be deemed to continue to belong to the Hindu undivided family and no member will be deemed to have separated from the family.
- (iii) Each member or group of members of such family will be jointly and severally liable for any tax, interest, penalty, fine or other sum payable under the Act by the family, whether before or after such partition. The several liability of any member or group of members of such family will be computed according to the portion of the joint family property allotted to him on such partial partition. This amendment has come into force with effect from April 1, 1980 and has, accordingly, been applicable with effect from assessment year 1980-81 and onwards.

TAXATION OF FIRMS

Under Section 2(23) of the Income-tax Act, the terms "firm", "partner", and "partnership" have the meanings respectively assigned to them in the Indian Partnership Act, 1932 and Limited Liability Partnership Act, 2008.

The expression "partner" also includes a minor who has been admitted to the benefits of partnership and a partner of a Limited Liability Partnership Act 2008. However a minor cannot validly enter into any partnership as a 'full partner' with other persons but he can be admitted to the benefits of partnership only.

A joint Hindu family as such cannot be a partner in a firm. However, through its Karta it may enter into a valid partnership with a third person or with a member of the undivided family in his individual capacity. In such a case, the Karta occupies a dual position. On the partnership he functions in his individual capacity; on the relations to other members of the Hindu undivided family, in his representative capacity.

An incorporated company being a legal person may form a partnership with an individual or with another company. In considering the maximum number of partners comprising a firm, the company will be considered as one person only.

A partnership firm as such is not entitled to enter into a partnership with another firm, H.U.F., individual, or a company. However, its partners in their individual capacity can enter into another partnership.

(1) Scheme of taxation of a firm and its partners

Assessment as a Firm (Section 184)

As per the scheme, a partnership firm in the first assessment year shall be assessed as a firm if the following conditions are satisfied:

1. The partnership is evidenced by an instrument i.e. partnership deed.
2. The individual shares of the partners are specified in that instrument.
3. A copy of the partnership deed certified by all the partners in writing (other than the minors) is submitted along with the return of income in respect of which assessment as a firm is first sought.

Where the return is made after the dissolution of the firm, the copy of the partnership deed should be certified in writing by all persons (excluding minors) who were partners of the firm immediately before its dissolution and by the legal representative of any deceased partner.

When a **firm is assessed as such for any assessment year**, it shall be assessed in the same capacity for every subsequent year if there is no change in the constitution of the firm or in the shares of partners as evidenced by the partnership deed on the basis of which assessment as a firm was first sought.

Where any such change has taken place in the previous year, the firm shall furnish a certified copy of the revised instrument of partnership along with the return of income for the assessment year relevant to such previous year. In doing so all the provisions of Section 184 will apply to the firm.

Circumstances where the firm will be assessed as a firm but shall not be eligible for deduction on account of interest, salary, bonus, etc.

Where the firm –

- (a) fails to make the return required under Section 139(1) and has not made a return or revised return under Section 139(4) or 139(5), or
- (b) fails to comply with all the terms of a notice issued under Section 142(1) or fails to comply with a direction issued under Section 142(2A), or
- (c) having made a return, fails to comply with all the terms of a notice issued under Section 143(2),
- (d) does not comply with three conditions mentioned above u/s 184.

then the firm shall not be eligible for any deduction on account of interest to a partner and remuneration to a working partner although the same is mentioned in the partnership deed.

Rate of tax

In the case of a firm which is assessable as such (i.e. as a firm), tax is chargeable on its total income at the rate of 30%

Surcharge @10% shall be applicable where the total income exceeds ₹ 1 crore.

Partnership is not a separate entity distinct from the partners, but for tax purposes a partnership is taxed as a separate entity and therefore total income will be computed under various heads of income. A partnership firm is also entitled for deductions under section 30 to 37 for expenditures incurred. However, for payment of remuneration to partners and interest on capital are allowed subject to conditions laid down under section 40(b).

Section 40(b), contain the following conditions which need to be complied with while making payment of remuneration and interest on borrowed capital to the partners:

- (i) Payment of salary, bonus, commission or remuneration by whatever name called to a non-working

partner shall not be allowed as deduction. Such payments are allowed only to working partners if it is authorised by and is in accordance with partnership deed.

- (ii) Interest payable to a partner, although authorised by the partnership deed shall be allowable as deduction subject to a maximum of 12% p.a. If the partnership deed provides for interest at less than 12% p.a, the deduction of interest shall be allowed to the extent provided by the partnership deed.
- (iii) the payment of remuneration to working partner, although authorised by partnership deed however it is subject to maximum of the following limits.

Finance Act, 2009 provides for uniform limits for both professional firms and non professional firms:

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

Meaning of Book Profit [Explanation 3 to section 40(b)]

Book-profit" means the net profit, as shown in the profit and loss account and make the additions and deductions as per section 28 to 44D explained under the head income from Business and Profession 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 computing the net profit. Interest paid/payable to partners in excess of 12% shall also be disallowed as per section 40(b).

(2) Change in Constitution of a Firm (Section 187)

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

For the purposes of this section there is a change in the constitution of a firm if:

- (a) one or more of the partners cease to be partners or one or more new partners are admitted, in such circumstances that one or more of the persons who were partners of the firm before the change continue as partner or partners after the change (this clause, however, shall not apply to a case where the firm is dissolved on the death of any of its partners) or
- (b) where all the partners continue with a change in their respective shares or in the shares of some of them.

(3) Losses of Registered Firms (Section 75)

Carry forward and set off of losses in case of change in constitution of firm or on succession [Section 78(1)]

Where a change has occurred in the constitution of a firm on account of death or retirement, the firm is not entitled to carry forward and set off so much of the loss proportionate to the share of a retired or deceased partner as exceeds his share of profits, if any, in the firm in respect of the previous year.

Method of computation of amount not to be allowed to be carried forward

Step 1: In the year of change first ascertain the share of outgoing partner in the profit or loss of the firm.

Step 2: Compute share of loss of the outgoing partner for each of the preceding years from which the loss is carried forward.

Step 3: Amount not allowed to be carried forward:

- (i) Sum of [Amounts computed in Steps (1) and (2) where there is loss in the year of change].
- (ii) Difference of [Amounts computed in Steps (1) and (2) in case of profit in the year of change].

(4) Assessment of Partners

As per Section 10(2A) of the Act, any person who is a partner of a firm which is assessed as such, his share in the total income of the firm **will not be included in computing his total income**. Partner includes a minor admitted to the benefits of partnership as per Section 2(23) of the Act.

Further, the explanation to Sub-clause (2A) provides that the share of a partner in the total income of the firm assessed as a firm shall be an amount which bears to the total income of the firm the same proportion as the amount of his share in the profits of the firm (in accordance with the partnership deed) bears to such profits.

In terms of a formula, the **amount exempt** would be:

Partners share in the profit of the firm =

$$\frac{\text{as shown in the partnership deed}}{\text{Total Profits of the Firm}} \times \text{Total income of the firm}$$

Any interest, salary, bonus, commission or remuneration by whatever name called which is due to or received by a partner of a firm from the firm will be chargeable to tax in the hands of the partner under the head "profits and gains of business or profession". However, if such salary, interest, bonus, commission or remuneration (or any part thereof) has not been allowed as deduction as per Section 40(b) in the hands of the firm, the amount not allowed as deduction shall not be charged to tax in the hands of partners.

Further, deductions under Sections 32 to 37 can be claimed by a partner from any income where any expenditure was incurred to earn such income.

(5) Succession of one firm by another firm (Section 188)

When all the partners in the predecessor firm are replaced by new partners in the successor firm, it is known as succession of one firm by another firm. If a firm is dissolved and some of the partners take over the firm's business or carry on a similar business with or without new partners, it would be a case of succession by a new firm (62 I.T.R. 75).

In *CIT v. K.H. Chambers (1965) 55 ITR 674*, the Supreme Court laid down the following requisites of succession:

- (i) There is a change of ownership.
- (ii) The whole business is transferred.
- (iii) Substantially the identity and the continuity of the business are preserved.

Where the partnership deed does not provide specifically for continuance of the firm on the death of a partner, there would be no change in constitution of the firm but it would be a case of succession. [Addl. *CIT v. Thyagasundara Mudaliar (1981) 127 ITR 520*].

Where a firm is succeeded by another firm, separate assessments are made on the predecessor and successor firms respectively in accordance with the provisions of Section 170 which provides that the predecessor shall be assessed in respect of the income of the previous year in which the succession took place up to the date of succession and the successor shall be assessed in respect of the income of the previous year after the date of succession. If the predecessor cannot be found, or the tax assessed on the predecessor cannot be recovered from him for the previous year (in which the succession took place) and the previous year immediately preceding such previous year, the unrealised tax payable by the predecessor shall be recovered from the successor.

However, the successor firm is entitled to recover from the predecessor firm any tax paid by it on behalf of the former. If any tax is due against any partner of the predecessor firm, it cannot be recovered from the successor firm.

Joint and several liability of partners for tax payable by firm (Section 188A)

As per this section every person who was, during the previous year, a partner of a firm, and the legal representative of any such person who is deceased, shall be jointly and severally liable along with the firm for the amount of tax, penalty or other sum payable by the firm for the assessment year to which such previous year is relevant, and all the provisions of Income-tax Act, so far as may be, shall apply to the assessment of such tax or imposition or levy of such penalty or other sum.

Firm Dissolved or Business Discontinued (Section 189)

Where any business or profession carried on by a firm has been discontinued or where a firm is dissolved, the assessment of the total income of the firm shall be made as if no such discontinuance or dissolution had taken place and all the provisions of the Act, including the provisions relating to penalty or any other sum (interest, fine) chargeable under the Act, shall apply. Consequently, every person who was a partner of the firm at the time of discontinuance of business or dissolution of the firm and legal representative of the deceased partner shall be jointly and severally liable to the amount of tax penalty and any other sum. Where the dissolution or discontinuance of business takes place after any proceedings in respect of an assessment year have commenced, the proceedings may be continued against the partners or legal representative of a deceased partner from the stage at which the proceedings stood at the time of such dissolution or discontinuance.

Thus, every partner of the firm and the legal representative of the deceased partner is liable to pay the tax which is already due or may have become due after the dissolution, irrespective of his interest in the firm. However, if there was any irrecoverable amount at the time of dissolution or discontinuance of business and later on it was recovered by the partners, the partners shall personally pay the tax on their share so recovered.

(6) Computation of income on estimated basis in case, taxpayers are engaged in certain business (Section 44AD)

An assessee being an individual, a resident HUF or a partnership firm (not being a LLP), who has not claimed any deduction under Sections 10A, 10AA, 10B, 10BA, 80HH to 80 RRB in the relevant assessment year is eligible to pay tax on estimated basis.

Further, the assessee should be engaged in any business (whether it is retail trading or wholesale trading or civil construction or any other business). The turnover/gross receipt of the eligible business should not exceed ₹1 crore during the previous year.

The following persons are not eligible to avail benefit under Section 44AD:

- (a) a person carrying on profession as referred to in Section 44AA(1) or
- (b) a person earning income in the nature of commission or brokerage or
- (c) a person carrying on any agency business or
- (d) a person who is in the business of plying, hiring or leasing goods carriages.

If the above conditions are satisfied, the income from eligible business is estimated @ 8% of gross receipt or total turnover. Further, it is assumed that all the deductions have been allowed and no other deduction is allowed.

However, in case of firm, the normal deduction in respect of salary and interest to partners under Section 40(b) shall be allowed.

Other Provisions relating to Limited Liability Partnership:

(1) Transfer of capital asset or intangible asset by a private Limited company or a non-listed company to Limited Liability Partnership and correspondingly any transfer of a share or shares held in a company by a shareholder shall not be treated as transfer:

Any transfer of a capital asset or intangible asset by a private company or unlisted public company (hereafter in this clause referred to as the company) to a limited liability partnership or any transfer of a share or shares held in the company by a shareholder as a result of conversion of the company into a limited liability partnership in accordance with the provisions of section 56 or section 57 of the Limited Liability Partnership Act, 2008 shall not be treated as transfer for the purpose of capital gain under section 45 subject to the following conditions:

- (a) all the assets and liabilities of the company immediately before the conversion become the assets and liabilities of the limited liability partnership;
- (b) all the shareholders of the company immediately before the conversion become the partners of the limited liability partnership and their capital contribution and profit sharing ratio in the limited liability partnership are in the same proportion as their shareholding in the company on the date of conversion;
- (c) the shareholders of the company do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of share in profit and capital contribution in the limited liability partnership;
- (d) the aggregate of the profit sharing ratio of the shareholders of the company in the limited liability partnership shall not be less than fifty per cent at any time during the period of five years from the date of conversion;
- (e) the total sales, turnover or gross receipts in the business of the company in any of the three previous years preceding the previous year in which the conversion takes place does not exceed sixty lakh rupees; and
- (f) no amount is paid, either directly or indirectly, to any partner out of balance of accumulated profit standing in the accounts of the company on the date of conversion for a period of three years from the date of conversion.

(2) Consequential amendments due to conversion of a private limited company or a non-listed company into LLP:

- (i) **Allowability of depreciation:** Aggregate deduction, in respect of depreciation of buildings, machinery, plant or furniture, being tangible assets or know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, being intangible assets allowable to the predecessor and the successor in the case of succession of company into LLP, shall not exceed in any previous year the deduction calculated at the prescribed rates as if the succession, had not taken place.
- (ii) **Successor LLP will be allowed deduction of payment under Voluntary Retirement Scheme for the unexpired period:** Where a private company or unlisted public company is succeeded by a limited liability partnership fulfilling the conditions laid down in the proviso to clause (xiib) of section 47, the provisions of this section shall, as far as may be, apply to the successor limited liability partnership, as they would have applied to the said company, if reorganisation of business had not taken place.]
- (iii) Cost of Acquisition of the asset in case the predecessor company has claimed deduction under section 35AD shall be taken to be nil in the hands of LLP.
- (iv) **Actual cost of the block of the asset in the hand of successor LLP:**

Where in any previous year, any block of assets is transferred by a private company or unlisted public company to a limited liability partnership and the conditions specified in the proviso to clause (xiib) of section 47 are satisfied, then, notwithstanding anything contained in clause (1), the actual cost of the

block of assets in the case of the limited liability partnership shall be the written down value of the block of assets as in the case of the said company on the date of conversion of the company into the limited liability partnership.

(v) Carry Forward and set off of losses (Section 72A(6A):

Where there has been reorganisation of business whereby a private company or unlisted public company is succeeded by a limited liability partnership fulfilling the conditions laid down in the proviso to clause (xiib) of section 47, then, notwithstanding anything contained in any other provision of this Act, the accumulated loss and the unabsorbed depreciation of the predecessor company, shall be deemed to be the loss or allowance for depreciation of the successor limited liability partnership for the purpose of the previous year in which business reorganisation was effected and other provisions of this Act relating to set off and carry forward of loss and allowance for depreciation shall apply accordingly.

However, if any of the conditions laid down in the proviso to clause (xiib) of section 47 are not complied with, the set off of loss or allowance of depreciation made in any previous year in the hands of the successor limited liability partnership, shall be deemed to be the income of the limited liability partnership chargeable to tax in the year in which such conditions are not complied with.

“Accumulated loss” means so much of the loss of the predecessor firm or the proprietary concern or the private company or unlisted public company before conversion into limited liability partnership or the amalgamating company or the demerged company, as the case may be, under the head “Profits and gains of business or profession” (not being a loss sustained in a speculation business) which such predecessor firm or the proprietary concern or the company or amalgamating company or demerged company, would have been entitled to carry forward and set off under the provisions of section 72 if the reorganisation of business or conversion or amalgamation or demerger had not taken place.

“Unabsorbed depreciation” means so much of the allowance for depreciation of the predecessor firm or the proprietary concern or the private company or unlisted public company before conversion into limited liability partnership or the amalgamating company or the demerged company, as the case may be, which remains to be allowed and which would have been allowed to the predecessor firm or the proprietary concern or the company or amalgamating company or demerged company, as the case may be, under the provisions of this Act, if the reorganisation of business or conversion or amalgamation or demerger had not taken place.

(vi) MAT credit of the predecessor company will lapse.

(7) Alternate Minimum Tax (AMT) (Section 115JC)

Where the regular income tax payable for a previous year by a person other than a company is less than the alternate minimum tax payable for such previous year then the adjusted total income shall be deemed to be the total income of that person for such previous year and it shall be liable to pay income tax on such adjusted total income @ 18.5% plus education & SHEC @ 3%.

Upto Assessment Year 2012-13, Alternate Minimum Tax (AMT) is levied on limited liability partnerships (LLPs). However, no such tax is levied on the other form of business organisations such as partnership firms, sole proprietorship, association of persons, etc.

In order to widen the tax base vis-à-vis profit linked deductions, the provisions regarding AMT has been broadened to cover all persons 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, shall be liable to pay AMT.

Accordingly, where the regular income-tax payable for a previous year by a person (other than a company) is

less than the alternate minimum tax payable for such previous year, the adjusted total income shall be deemed to be the total income of such person and he shall be liable to pay income-tax on such total income at the rate of **eighteen and one-half per cent.**

For the purpose of the above,

(i) "adjusted total income" shall be the total income before giving effect to provisions of Chapter XII-BA as increased by the deductions claimed under any section (other than section 80P) included in Chapter VI-A under the heading "C – Deductions in respect of certain incomes" and deduction claimed under section 10AA;

(ii) "alternate minimum tax:" shall be the amount of tax computed on adjusted total income at a rate of eighteen and one half per cent; and

(iii) "regular income-tax" shall be the income-tax payable for a previous year by a person other than a company on his total income in accordance with the provisions of the Act other than the provisions of Chapter XII-BA.

It is further provided that the provisions of AMT under Chapter XII-BA shall not apply to an individual or a Hindu undivided family or an association of persons or a body of individuals (whether incorporated or not) or an artificial juridical person referred to in section 2(31)(vii) if the adjusted total income of such person **does not exceed twenty lakh rupees.**

It is also provided that the credit for tax (tax credit) paid by a person on account of AMT under Chapter XII-BA shall be allowed to the extent of the excess of the AMT paid over the regular income-tax. This tax credit shall be allowed to be carried forward up to the tenth assessment year immediately succeeding the assessment year for which such credit becomes allowable. It shall be allowed to be set off for an assessment year in which the regular income-tax exceeds the AMT to the extent of the excess of the regular income-tax over the AMT.

Every person to which this section applies shall obtain a report, in such form as may be prescribed from an accountant certifying that the adjusted total income and the alternate minimum tax have been computed in accordance with the provisions of this Chapter and furnish such report on or before the due date of filing of return under sub-section (1) of section 139.

Illustration

A, B and C are the partners for 3:2:1 share respectively, in a firm engaged in medical profession. Compute the total income of the firm for the year ended 31st March, 2014:

	₹		₹
Office Expenses	15,400	Gross Profit	40,000
Income Tax	1,000	Net Loss A	8,700
Salary to A	5,000	Net Loss B	5,800
Salary to B	4,000	Net Loss C	2,900
Salary to C	10,000		
Bonus to A	10,000		
Bonus to C	12,000		
	<u>57,400</u>		<u>57,400</u>

Solution:

Computation of Book Profit of the Firm

	₹
Net Loss as per P & L A/c	(17,400)
<i>Add: Inadmissible Expenses:</i>	₹
Income-tax	1,000
Salary to partners:	₹
A	5,000
B	4,000
C	<u>10,000</u>
	19,000
Bonus to partners	
A	10,000
C	<u>12,000</u>
	<u>22,000</u>
	<u>42,000</u>
Book Profit	<u>24,600</u>

Permissible remuneration to partners:

90% of first ₹ 3,00,000 of Book-profit or ₹1,50,000 whichever is more, is allowed as deduction. Here the permissible remuneration comes to ₹ 1,50,000, but as the partners have claimed ₹ 41,000 only, hence the entire amount will be allowed.

Computation of total income of the firm

	₹	₹
Book Profit		24,600
Less: Salary to Partners	19,000	
Bonus to Partners	<u>22,000</u>	<u>41,000</u>
Loss of the firm		<u>(16,400)</u>

Note: Loss of the firm will be carried forward by the firm to the next year(s).

Illustration

M, N and O are partners sharing profits and losses in the ratio of 2:1:1 respectively. Their summarised Profit and Loss A/c for the year ending 31st March, 2014 is appended below:

	₹		₹
Office salaries	5,680	Gross Profit	60,570
Telephone and Telegram	2,000	Rent received	6,000
Interest on loan from M	2,000	Interest on securities	4,000
Local taxes (let out property)		1,000	
Salary to N		3,000	

Commission to partners		
M	4,000	
N	5,000	
O	<u>6,000</u>	15,000
Collection charges of interest on securities		50
Bad debts reserve		1,000
Net Profit to partners:		
M	20,420	
N	10,210	
O	<u>10,210</u>	<u>40,840</u>
	<u>70,570</u>	<u>70,570</u>

Compute total income of the firm for the assessment year 2014-15 and tax liability thereon. Interest paid to M has been calculated at the rate of 20% p.a. simple.

Solution:

Computation of Book-Profit

	₹	₹
Net Income as per P & L A/c		40,840
<i>Add: Inadmissible items -</i>		
Local taxes (on let out property)	1,000	
Salary to N (Partner)	3,000	
Commission to partners	15,000	
Collection charges	50	
Bad debts reserve	<u>1,000</u>	<u>20,050</u>
		60,890
<i>Less: Other Incomes -</i>		
Rent received	6,000	
Interest on securities	<u>4,000</u>	<u>(10,000)</u>
Book Profit		<u>50,890</u>

Maximum remuneration payable to partners

Here ₹1,50,000 will be allowed as maximum remuneration. But as the partners have drawn only ₹ 18,000 by way of salary and commission, the entire amount will be allowed as deduction.

Computation of total income of the firm for the assessment year 2014-15

	₹
Book Profit:	50,890
Less: Salary and commission to partners	<u>(18,000)</u>

– Taxable Business Profit	<u>32,890</u>	...(A)
– Income from house property		
Rent received	6,000	
Less: Municipal taxes	<u>(1,000)</u>	
Net adjusted annual value (NAAV)	5,000	
Less: Repairs (30% of NAAV) u/s 24	<u>(1,500)</u>	
	<u>3,500</u>	...(B)
– Income from other sources:		
Interest on Securities	4,000	
Less: Collection charges	<u>(50)</u>	<u>3,950</u> ...(C)
GROSS TOTAL INCOME (A) + (B) + (C)		
	= ₹ 32,890 + 3,500 + 3,950	
	= ₹ 40,340	

The firm will have to pay tax on ₹ 40,340 @ 30%, which comes to ₹ 12,102 plus education cess @ 3% on 12,102 making the total liability as ₹ 12,465.

TAXATION OF ASSOCIATION OF PERSONS

'Association of persons' has not been defined in the Income-tax Act. However in the case of *CIT v. Indira Balkrishna* [(1960) 39 ITR 546] the Supreme Court has defined it as:

"Association of persons" means an association in which two or more persons join in for a common purpose or common action to produce income, profits or gains.

An association of persons may consist of non-individuals (Companies, firms joint families) [*Ipoth v. CIT* (1968) 67 ITR 106 (S.C.)]. A minor can join an AOP if his lawful guardian gives his consent. [*Murugesan & Bros. v. CIT* (1973) 88 ITR 432 (SC)].

Applying the ratio laid down by the Supreme Court in the case of *G. Murugesan and Bros. v. Commissioner of Income-tax* (1973, 88 ITR 432), the Kerala High Court held in the case of *Commissioner of Income-tax v. Goel C. Dalal and Perin C. Dalal* (1990, 184 ITR 248) that in order to acquire the status of an association of persons, the persons must join in a common purpose or action and the object of the association must be to produce income. It is not enough that the persons receive the income jointly.

Formation of an Association of Persons

For the formation of an AOP the association need not necessarily be on the basis of a contract, consent and understanding may be presumed [*Shanmugham & Co. v. CIT* (1971) 81 ITR 310 (S.C.)].

Applying the ratio laid down by the Supreme Court in the case of *N.V. Shanmugham & Co. v. Commissioner of Income-tax* (1971, 81 ITR 310) the Calcutta High Court held in the case of *Gopal Chand Sen v. Income-tax Officer and others* (1977, 109 ITR 820) that an assessment of business income has to be done in the hands of receivers and in such an assessment, the receivers are never assessed as independent earners of income. The income in the hands of the receiver is assessable in the like manner and to the same extent as it would have been assessed on the real owners.

However, co-owners, co-heirs or co-legatees do not constitute an AOP in respect of the income of the joint or common asset by reason only of their jural relationship. But if they write themselves with the objective of earning income they constitute an AOP for assessment purposes. [*Estate of Mohamed Rowther v. CIT* (1963, 49 ITR 39)]. Section 26 of the Income-tax Act provides that where property consisting of building or buildings and lands appurtenant thereto is owned by two or more persons in definite and ascertainable shares, such persons shall not, in respect of such property be assessed as an AOP, but on their respective share of income therefrom.

In order to constitute an association of persons, there must be joining together in a common purpose or in a common action, the object of which is to produce income, profits and gains. Though a body of individuals is not identical with an association of persons, they have some similarities. An association of persons may consist of non-individuals also but a body of individuals has to consist only of human beings. The word 'body' would require an association for some common purpose or for a common cause or there must be unity under some common tie or occupation. A mere collection of individuals without a common tie or common aim cannot be taken to be a body of individuals failing under Section 2(31) of the Income-tax Act, 1961. [See *CIT v. Deghamwala Estates* (1980, 121 ITR 684)].

Tax Liability of Association of Persons

With effect from assessment year 1989-90, the following provisions are applicable to assessees other than companies, co-operative societies and societies registered under the Societies Registration Act, 1860 or any law corresponding to that Act in force in any part of India.

- (1) Interest paid by the AOP to a member will not be allowed as a deduction from the income of the Association of Persons [Section 40(ba)].
In cases where interest is paid by the AOP to any member, who has also paid interest to the AOP, the net amount of interest that will be disallowed is the amount of interest paid by the AOP to the member less the amount of interest paid to the AOP by the member [Explanation 1 to Section 40(ba)].
- (2) In cases where an individual is a member of an AOP in a representative capacity, any interest paid by the AOP to such individual or by such individual to the AOP, otherwise than in a representative capacity will not be subject to disallowance under explanation 2(i) to Section 40(ba).
- (3) In the cases of interest paid by AOP to such individual or by such individual to the AOP in a representative capacity any interest paid by the AOP to the person represented by such person or vice versa, will not be allowed under Section 40(ba) [Explanation 2(ii) to Section 40(ba)].
- (4) Explanation 3 to Section 40(ba) further provides that where an individual is a member of the AOP otherwise than as member in a representative capacity, any interest paid by the AOP to such individual will not be disallowed if the interest is received by him on behalf of any other person.
- (5) Any salary, bonus, commission or remuneration (by whatever name called) paid by the AOP to a member will not be allowed as a deduction.

Section 167B makes the following provisions as regards the incidence of charge of tax on the association of persons.

A. Where shares of members are determinate

In this case, tax is chargeable on the income of the association of persons at the same rate as applicable to an individual. However, where the total income of any member of the association of persons for the previous year (excluding his share of income from the association of persons) exceeds the maximum amount not chargeable to tax in the case of an individual, tax will be charged on the total income of the AOP at the maximum marginal rate of 30%, i.e. the highest slab applicable to an individual.

More so, where the total income of any member of the AOP, irrespective of whether or not it exceeds the

maximum amount not chargeable to tax in the case of an individual, is chargeable to tax at a rate higher than the maximum marginal rate, tax will be charged on the total income of the AOP at such higher rate.

B. Where the shares of the members are indeterminate

In these cases, tax will be charged on the total income of the AOP at the maximum marginal rate, that is, the rate of tax as well as surcharge, if any, applicable to the highest slab of income in the case of an individual as specified in the Finance Act of the relevant year.

The individual shares of the members in the whole or any part of the income of the AOP will be deemed to be indeterminate or unknown if such shares are indeterminate or unknown on the date of formation of the AOP, or at any time thereafter.

Method of Computing Share of a Member of Association of Persons, etc. (Section 67A)

Section 67A seeks to provide for the method of computing a member's share in the income of an association of persons or a body of individuals, wherein the shares of the members are determinate, in the same manner as provided for in Sub-sections (1) to (3) of Section 67 for computing a partner's share in a firm.

This section lays down the following methods of computing the member's share:

- (a) Any interest, salary, bonus, commission or remuneration, by whatever name called, paid to any member in respect of the previous year shall be deducted from the total income of the association or body and the balance ascertained and apportioned among the members in the proportion in which they are entitled to share the income of the association or body.
- (b) Where the amount apportioned to a member under (a) hereinabove is a profit, any interest, salary, bonus, commission or remuneration paid to the member by the AOP in respect of the previous year shall be added to that amount - the result shall constitute the member's share in the income of the association or body.
- (c) Where the amount apportioned to a member under (a) is a loss, any interest, salary, bonus, commission or remuneration aforesaid paid to the member by the association or body in respect of the previous year shall be adjusted against that amount, the result shall be adjusted against that amount, and the result shall be treated as the member's share in the income of the association or body.

See also explanatory notes on the provision of DTL (Amendment) Act, 1987 Board circular No. 551 dated 23.1.1990 [(1990, 183 ITR 1 (SC)].

Tax on Income of association of persons, etc. which is indeterminate or unknown (New Section 167B)

Section 167B seeks to provide that where the individual shares of the members of an association or body in the whole or any part of the income of such association or body are indeterminate or unknown, tax shall be charged on the total income of the association or body at the maximum marginal rate. However, where the total income of any member of such association or body is chargeable to tax at a rate which is higher than the maximum marginal rate, tax shall be charged on the total income of the association or body at such higher rate. Also, where the total income of any member of an association of persons or body of individuals as above for the previous year (excluding his share from such association or body) exceeds the maximum amount which is not chargeable to tax in the case of that member, tax shall be charged on the total income of the association or body at the maximum marginal rate. However, where any member or members of such association or body of individuals is or are chargeable to tax for the previous year at a rate or rates which is or are higher than the maximum marginal rate, tax shall be charged on that portion or portions of the total income of the association or body of individuals which is or are relatable to the share or shares of such member or members at such higher rate or rates, as the case may be, and the balance of the total income the association or body shall be taxed at the maximum marginal rate.

In the explanation to the above provisions, it is provided that the shares of the members of an association or body in the whole or any part of the income of such association or body shall be deemed to be indeterminate or unknown if such shares (in relation to the whole or any part of such income) are indeterminate or unknown on the date of formation of such association or body or any time thereafter.

Share of a member of association etc. (Section 86)

Section 86 relates to shares of members of an association of persons or a body of individuals in the income of the association or body. This section provides that if the assessee is a member of an association of persons or a body of individuals (other than a company or a Co-operative society or a Society registered under the Societies Registration Act, 1860, or any law corresponding to that Act in force in any part of India), his share in the income of the association or body, computed in the manner provided in Section 67A shall not be liable to tax.

Further, where the association or body is chargeable to tax on its total income at the maximum marginal rate or any higher rate, under any of the provisions of the Income-tax Act, his share computed in the manner stated above shall not be included in his total income.

But, in other cases and in cases where no income-tax is chargeable on the total income of the association or body, the member's share shall be chargeable to tax as part of his total income and Section 86 shall not be applicable to such case.

The charge of tax on the member's share in AOP will depend on the following factors:

- (i) Income-tax is not payable by the member in respect of his share in the income of the AOP, computed in the manner provided in Section 67A.
- (ii) His share in the income of the AOP is includable in his total income for rate purposes.
- (iii) Where the AOP is chargeable to tax on its total income at the 'maximum marginal rate' or at any higher rate, the share of the member will not be includable in his total income. In this case, the member's share in the income of the AOP will not be included in his income even for rate purposes.
- (iv) In any other case, the member's share will form part of his total income.
- (v) Where no income-tax is chargeable on the total income of the AOP, the share of the member will be chargeable to tax part of his total income. Section 86 will not be applicable to such cases.

Assessment in case of Dissolution of an Association of Persons (Section 177)

Where any business or profession carried on by an AOP has been discontinued or an AOP is dissolved, the Assessing Officer shall make an assessment of the total income of the AOP as if no such discontinuance or dissolution had taken place, and all provisions of this Act, including the provisions relating to the levy of penalty or any other sum chargeable under any provisions of the Income-tax Act shall apply.

Every person who was at the time of such discontinuance or dissolution a member of the AOP and the legal representative of any such person who is deceased, shall jointly and severally be liable for the amount of tax, penalty or other sum payable.

Where such discontinuance or dissolution takes place after any proceeding in respect of an assessment year have commenced, the proceedings may be continued against the members from the stage at which the proceedings stood at the time of such discontinuance or dissolution.

TAXATION OF CO-OPERATIVE SOCIETIES

Meaning [Section 2(10)]

'Co-operative Society' means a co-operative society registered under the Co-operative Societies Act, 1912, or

under any other law for the time being in force in any State for the registration of co-operative societies.

A regional rural bank (to which provisions of the Regional Rural Bank Act, 1976, apply) is deemed to be a co-operative society [Circular No. 319 dated 11.1.1982].

Computation of Income of Co-operative Societies

The income of a co-operative society is computed in the same manner as provided for other assessees. Further, the subsidy given by the government to a co-operative society for meeting managerial expenses and admission fee collected by the society is treated as revenue receipt and liable to tax. [*Ludhiana Central Co-operative Consumers' Stores Ltd. v. C.I.T. (1980) 122, I.T.R. 942*].

There is, however difference of opinion with regard to tax treatment of 'subsidy' received from the Government. Distinguishing the ratio laid down by the Punjab & Haryana High Court in the case of *Ludhiana Central Co-operative Consumers' Stores Ltd. v. Commissioner of Income-tax* (1980, 122 ITR 942), the Punjab & Haryana High Court held in the case of *Commissioner of Income-tax v. Jindal Brothers Rice Mills* (1989, 179 ITR 470) that depreciation is allowable on the cost of the machinery or plant reduced by the amount of the subsidy as actual cost stands reduced by the percentage allowed by the subsidy. Though this case was followed by it in the case of *Commissioner of Income-tax v. Janak Steel Tubes (Pvt.) Ltd.* (1989, 179 ITR 536) (the capital subsidy should be deducted from the value of plant and machinery) but had been dissented from by the Bombay, Madras and Rajasthan High Courts in the following cases:

- (i) ***Srinivas Industries v. Commissioner of Income-tax (1991, 188 ITR 22)***: The Madras High Court held that the subsidy really partook the character of cash grant expendable for any purpose-consequently, the amount of subsidy granted could not be deducted from the capital cost of the machinery.
- (ii) ***In Commissioner of Income-tax v. Elys Plastics Pvt. Ltd. (1991, 188 ITR 11)*** the Bombay High Court held that the subsidies were not deductible in computing the cost of plant and machinery for purposes of allowing depreciation.
- (iii) ***In Commissioner of Income-tax v. Ambica Electrolytic Capacitors (P) Ltd. and others (1991, 191 ITR 494)*** the Rajasthan High Court held that the subsidy or investment subsidy given by the Government cannot be deducted from the actual cost for purposes of investment or depreciation allowance.

A co-operative society is entitled to the deductions from its gross total income under Sections 80G, 80GGA, 80GGC, 80-IA, 80-IB, 80JJA and 80P.

Deduction in respect of income of co-operative societies (Section 80P)

Section 80P provides for certain deductions from the gross total income of a Co-operative Society. These deductions are:

- (a) In the case of Co-operative Society engaged in:
 - (i) the business of Banking or providing credit facilities to its members, or
 - (ii) a cottage industry, or
 - (iii) the marketing of the agricultural produce grown by its members, or
 - (iv) the purchase of agricultural implements, seeds, livestock or other articles intended for agriculture for purpose of supplying them to its members, or
 - (v) the processing, without the aid of power, of the agricultural produce of its members, or
 - (vi) the collective disposal of the labour of its members, or
 - (vii) fishing or allied activities, i.e., catching, curing, processing, preserving, storing or marketing of fish

or the purchase of materials and equipment in connection therewith for the purpose of supplying them to its members,

the whole of the amount of profits and gains of business attributable to any one or more of such activities shall be deducted from the gross total income provided that in the case of a co-operative society falling under Sub-clause (vi) or (vii), the rules and bye-laws of the society restrict the voting rights to the following classes of its members:

- (i) the individuals who contribute their labour or carry on the fishing or allied activities;
- (ii) the co-operative credit societies which provide financial assistance to the society;
- (iii) the State Government.

(b) In the case of primary co-operative society engaged in supplying milk, oilseeds, fruits, vegetables raised or grown by its members to

- (i) a federal co-operative society engaged in supplying the above mentioned products; or
- (ii) a Government or a local authority; or
- (iii) a Government Company or a Corporation established by or under a Central, State or a Provincial Act (being a company or corporation engaged in supplying the above mentioned products to the public).

the whole of the amount of profits and gains of such business shall be deducted from the gross total income.

In the case of a co-operative society engaged in activities other than those specified in clauses (a) or (b) either independently of, or in addition to, profits and gains attributable to the activities mentioned at clauses (a) and (b) deduction from the gross total income will be allowed to the extent of ₹ 50,000 w.e.f. assessment year 1999-2000.

(c) Where such co-operative society is a Consumers' Co-operative Society, the deduction shall be ₹ 1,00,000 w.e.f. assessment year 1999-2000.

(d) In the case of every co-operative society, the whole of the income by way of interest or dividends derived from its investments with any other co-operative society shall be deducted from the gross total income.

(e) In the case of every co-operative society, the whole of the income derived by the society from the letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities shall be deducted from its gross total income.

(f) In the case of every co-operative society, not being a housing society or an urban consumers' society, or a society carrying on transport business or a society engaged in the performance of any manufacturing operations with the aid of power, where the gross total income does not exceed ₹ 20,000 the amount of any income by way of interest on securities or any income from house property shall be deducted from the gross total income.

Urban Consumers' Co-operative Society

An urban consumers' co-operative society means a society for the benefit of consumers, within the limits of a municipal corporation, municipality, notified areas committee, town area or, cantonment [Explanation to Section 80P(2)].

The provisions of this Section shall not apply in relation to any cooperative bank other than a primary agricultural credit society or a primary cooperative agricultural and rural development bank.

Assessment of Co-operative Societies

The following are the provisions which are specifically applicable to the assessment of Co-operative Societies -

I. Co-operative Housing Society. Under Section 27(iii), a member of co-operative society, company or other

association of persons to whom a building or part thereof is allotted or leased under a house building scheme of the society, company or association, as the case may be, shall be deemed to be owner of that building or part thereof.

Clause (iiia) further provides that a person who is allowed to take or retain possession of any building or part thereof in part performance of a contract of the nature referred to in Section 53A of the Transfer of Property Act, 1882 shall be deemed to be the owner of that building or part thereof; and

As per Clause (iiib), a person who acquires any rights (excluding any rights by way of a lease from month to month or for a period not exceeding one year) in or with respect to any building or part thereof, by virtue of any such transaction as is referred to in Clause (f) of Section 269UA, shall be deemed to be the owner of that building or part thereof.

Clause (f) of Section 269UA, it may be noted, defines “transfer” for the purposes of Chapter XX-C of the Income-tax Act, dealing with purchase by Central Government of immovable properties in certain cases of transfer.

II. Profits and Gains of Co-operative Society from insurance business (Section 44). The profits and gains of any business of insurance carried on by a Co-operative Society shall be computed in accordance with the rules contained in the First Schedule.

In this connection, the First Schedule and Rule 6E of the Income-tax Rules, 1962 provides as under:

The profits of non-life insurance business, e.g., Fire insurance business, marine insurance business, general insurance business etc. shall be the profits disclosed by the annual accounts required to be prepared under the Insurance Act, 1938 subject to the following adjustments:

- (i) If such profits are arrived at after deducting any expenditure or allowance which is not admissible under Sections 30 to 43B of the Income-tax Act, such expenditure or allowance shall be added back to the profits.
- (ii) The reserve for unexpired risks shall be allowed as a deduction to the following extent:
 - (a) where the insurance business relates to fire insurance or miscellaneous insurance - 50% of the net premium income of such business of the previous year;
 - (b) where the insurance business relates to marine insurance, 100% of the net premium income of such business of the previous year.

‘Net premium income’ means the amount of premium received, as reduced by the amount of re-insurance premiums paid during the relevant previous year.

In the context of computing the total income of co-operative society, the following cases are worth noting.

(1) Where the credit facility is extended to members of the society by virtue of sale of goods to them by consumers’ co-operative society, the exemption is not available. When the society sells goods on credit to its members, such transaction cannot be construed as a credit society to which the benefit of Section 80P(2)(a)(i) can be extended. [*Rodier Mill Employees’ Co-operative Stores Ltd. v. C/I.T.* (1982) 135 ITR 355].

Following the ratio laid down by the Madras High Court in the case of *Rodier Mill Employees’ Co-operative Stores Ltd. v. Commissioner of Income-tax* (1982, 135 ITR 355), the Kerala High Court held in the case of *Kerala Co-operative Consumers Federation Ltd. v. Commissioner of Income-tax* (1988, 170 ITR 455) that the words ‘providing credit facilities’, occurring in Section 80P(2)(a)(i) of the Income-tax Act, 1961 should be construed as similar to, or akin to the ‘carrying on the business of banking’, preceding the words “or providing credit facilities” in the same sub-section. The words ‘providing credit facilities to its members’ means providing credit by way of loans and not selling goods on credit.

(2) Where society purchases auto-rickshaws and sells them to members on hire-purchase, it is not providing

credit facility to members and not entitled to exemption [*C.I.T. v. Madras Auto Rickshaw Drivers' Co-operative Society* (1983) 143 ITR 981]. In this case it was held that the tax relief under Section 80P(2)(a)(i) of the Income-tax Act, is a grant not to a category of income but to a category of assessee namely, a co-operative society answering the description of a society engaged in carrying on the business of providing credit facilities to its members. If the society in question does not answer to this description, it is not entitled to the relief.

(3) In ***Bihar State Co-operative Bank Ltd. v. C.I.T.*** [(1960) 39 I.T.R. 114] the Supreme Court has held that if a co-operative society carrying on banking business invests its circulating capital in such a manner that it is readily available, the interest on such investment shall constitute income from banking business and therefore shall be exempt in the hands of the co-operative society.

(4) Interest received on Government Securities held by co-operative society as its stock-in-trade qualifies for deduction from gross total income. But the deduction is inapplicable to interest received from Government Securities held as investments. [*CIT v. Bombay State Co-operative Bank Ltd.* (1968) 70 ITR 86 (S.C.)].

The Madhya Pradesh High Court held in the case of *M.P. State Co-operative Bank Ltd. v. Addl. Commissioner of Income-tax* (1979, 119 ITR 327) that income from investment of reserve capital in securities was not a part of the income from banking business and did not qualify for exemption. Similarly, the interest income from investment of provident fund income did not form part of the income from the banking business and did not qualify for exemption under Section 80(i)(a) (now Section 80P). Distinguishing the ratio laid down in this case, the Madhya Pradesh High Court held in the case of *Commissioner of Income-tax v. Bhopal Co-operative Central Bank Ltd.* (1987, 164 ITR 713) that the security deposits made are in accordance with the Banking Regulation Act, 1949 and interest income received on deposits formed part of income from business of banking and exempt under Section 80P(2)(i) of the Income-tax Act, 1961.

The Allahabad High Court held in the case of *Addl. Commissioner of Income-tax v. U.P. Co-operative Cane Union* (1978, 114 ITR 70) that selling goods on credit was only a mode of carrying on business. It did not become a business of providing credit facility. Following this case, the Allahabad High Court held in the case of *Commissioner of Income-tax v. U.P. Co-operative Cane Union Federation Ltd.* (1980, 122 ITR 913) that the expression 'providing credit facilities' in Section 80P(2)(a)(i) would comprehend the business of lending money on interest. It would also comprehend the business of lending services on profit for guaranteeing payments because guaranteeing payment is as much a part of banking business for affording credit facility as advancing loans.

However, where a co-operative society holds securities as per requirements of Banking Regulation Act and directions of the RBI, the deduction is available on such interest income. Similarly, subsidy from Government for opening new branches and giving loans to poorer sections at lower rate of interest, is income attributable to banking business [*CIT v. Madurai District Central Co-operative Bank Ltd.* (1984) 148 ITR 196].

(5) The Income earned by a co-operative society carrying on the business of banking and providing credit facilities to its members from commission and brokerage by dealing in bills of exchange, subsidy from Government, admission fee from members, incidental charges and financial penalties is attributable to the business of banking of providing credit facilities to its members and hence deductible under Section 80P(2)(a)(i) [*CIT v. Dhar Central Co-operative Bank* (1984) 149 ITR 438 (MP)].

Following its decision in the case of *Commissioner of Income-tax v. Dhar Central Co-operative Bank* (1984, 149 ITR 438), the Madhya Pradesh High Court held in the case of *Commissioner of Income-tax v. Bhopal Co-operative Central Bank Ltd.* (1988, 172 ITR 423) that a co-operative society carrying on the business of banking is entitled to exemption in respect of interest on securities, commission, subsidy, donation and locker rent. Again, the said decision was followed by it in the case of *Madhya Pradesh Rajya Sahakari Bank v. Commissioner of Income-tax* (1988, 174 ITR 150) holding that the income from commission, exchange and other miscellaneous income was attributable to the business of banking and that the assessee was entitled to exemption under Section 81 (now 80P) of the Income-tax Act, 1961 in respect thereof.

(6) A society which buys and sells products of other societies or individuals is not entitled to exemption. Where a society manufactures and sells its own products or the products of its members, such society is entitled to exemption. Hence, the Central Cottage Industries Emporium, New Delhi, is not entitled to exemption under Section 80P [*Addl. C.I.T. v. Indian Co-operative Union Ltd.* (1982) 134 ITR 108 (Delhi)].

If the godown or warehouse is let for a purpose other than storage, processing of facilitating the marketing of commodities, the income derived therefrom by a co-operative society would not be deductible under Section 80P [*C.I.T. v. Ahmedabad Maskati Cloth Dealers Co-operative Warehouses Society Ltd.* [(1986) 162 ITR 142 (Guj.)] it was also held in this case that shops in which wholesale or retail business in cloth is carried on cannot come within the meaning of 'godowns' or 'warehouses'.

The Gujarat High Court's decision in the case of *Commissioner of Income-tax v. Ahmedabad Maskati Cloth Dealers Co-operative Warehouses Society Ltd.* (1986, 162 ITR 142) had since been approved by the Supreme Court in the case of South Arcot District Co-operative Marketing Society Ltd. (infra). The Gujarat High Court had, *inter alia*, held that the words facilitating the marketing of commodities' would not lend colour to the words 'godowns or warehouses' so as to enlarge their meaning.

Income of co-operative societies (Section 80P)

Amount received for letting of godowns, incidental services of taking delivery of stock at rail-head and transporting it to godowns were also rendered and amount received was described as 'commission' was wholly exemption *C.I.T. v. South Arcot District Co-operative Marketing Society Ltd.* (1989) 43 Taxman 328/176 ITR 117 (SC).

Income from ginning and pressing of cotton is exempt. *Broach Distt. Co-operative Cotton Sales, Ginning & Pressing Society Ltd. v. CIT* (1989) 177 ITR 418/44 Taxman 439 (SC).

Where assessee, an apex co-operative society, derived (i) interest on cash security furnished by it for carrying on sugar agency business, and (ii) interest on temporary loans given by it for financing sugar business, while former interest was not exempt, latter was exempt under Section 14(3)(iii) of the 1922 Act, *CIT v. U.P. Co-operative Federation Ltd.* (1989) 176 ITR 435/43 Taxman 20 (SC).

Amount of subsidy received by assessee from National Co-operative Development Corpn. towards loss incurred on account of price fluctuation qualifies for deduction under Section 81(1)(c) - *CIT v. Punjab State Co-operative Supply & Marketing Federation Ltd.* (1989) 46 Taxman 156 (Punj. & Har.).

Proportionate expenditure relating to such business activities of assessee co-operative society as are contemplated by Section 80P(2) is not to be disallowed. *Baghapurana Co-operative Marketing Society Ltd. v. CIT* (1989) 178 ITR, 653/44 Taxman 92 (Punj. & Har.).

In the cases of agricultural produce, the agricultural produce marketed by assessee co-operative society need not have been produced by assessee's members - *CIT v. Punjab State Co-operative Supply & Marketing Federation Ltd.* (1989) 46 Taxman 156 (Punj. & Har.).

The expression 'the marketing of the agricultural produce of its members means that agricultural produce should be owned by its members, whether supplied by them (that is, the members) or purchased from the market or acquired from any other producer. *C.I.T. v. Haryana State Co-operative Supply & Marketing Federation Ltd.* (1989) 79 CTR (Punj. & Har.) 94.

Short-term call deposits are investment within the meaning of Section 80P(2)(d) *CIT v. Haryana Co-operative Sugar Mills Ltd.* (1989) 46 Taxman 28 (Punj. & Har.).

Rates of Income-tax

The rates of income-tax applicable to a co-operative society for the assessment year 2013-14 are as follows:

- | | |
|---|--|
| 1. Where the total income does not exceed ₹ 10,000 | 10% of total income. |
| 2. Where the total income exceeds ₹ 10,000 but total income exceeds ₹ 10,000. | ₹ 1,000 plus 20% of the amount by which the total income exceeds ₹ 10,000. |
| 3. Where the total income exceeds ₹ 20,000 | ₹ 3,000 plus 30% of the amount by which the total income exceeds ₹ 20,000. |

Education cess @ 3%.

Surcharge @ 10% shall be applicable where the total income exceeds ₹ 1 crore

Illustration

Delhi Co-operative Society derived the following incomes during the previous year (1.4.2013 to 31.3.2014 - assessment year 2014-15).

(1) Marketing of agricultural produce of its members	10,000
(2) Interest from members on delayed payment of the price of goods purchased	1,000
(3) Processing (without aid of power) of agricultural produce of its members	8,000
(4) Supplying milk to the Government (raised by its members)	15,000
(5) Agency business	25,000
(6) Dividends from other Co-operative Societies	15,000
(7) Income from letting of godowns	20,000
(8) Income from House Property	30,000

Compute the total income of the Delhi Co-operative Society.

Solution:

Computation of total income of Delhi Co-operative Society

	₹	₹
(1) Income from House Property	30,000	
Letting of godowns	<u>20,000</u>	50,000
(2) Income from Business:		
Marketing of agricultural product	10,000	
Processing of goods	8,000	
Supplying milk	15,000	
Agency business	<u>25,000</u>	58,000
(3) Income from other sources:		
Interest from members	1,000	
Dividends	<u>15,000</u>	<u>16,000</u>
Gross Income		<u>1,24,000</u>

Deductions under Section 80P:

(1) Letting of godowns	20,000
------------------------	--------

(2) Marketing of agricultural produce	10,000
(3) Processing of goods	8,000
(4) Supplying milk	15,000
(5) Agency business	25,000
(6) Dividends	<u>15,000</u>
Total income	<u>93,000</u>
	<u>31,000</u>

Notes:

- (1) Interest from members ₹ 1,000 is not deductible as it is not from the credit facilities provided to the member and for this purpose society cannot be said to be a credit society [*Rodier Mill Employees' Co-operative Stores Ltd. v. CIT* (1982) 135 ITR 355].
- (2) The gross total income of the society exceeds ₹ 20,000 hence deduction regarding income from house property is not available.

TONNAGE TAX SCHEME [SECTIONS 115V TO 115VZC] (W.E.F. A.Y. 2005-06)

To make the Indian shipping industry more competitive, a tonnage tax scheme for taxation of shipping profits has been introduced. Many maritime nations have introduced tonnage based taxation. Some of the basic features of the tonnage tax scheme are as follows:

- It is a scheme of presumptive taxation whereby the notional income arising from the operation of a ship is determined based on the tonnage of the ship.
- The notional income is taxed at the normal corporate rate applicable for the year. Tax is payable even if there is a loss in any year.
- A company may opt for the scheme and once such option is exercised, there is a lock in period of ten years. If a company opts out, it is debarred from re-entry for next ten years.
- Since this is a preferential regime of taxation, certain conditions like, creation of reserves, training etc. are required to be met. A company may be expelled in certain circumstances.
- The income is computed under Section 115VG in respect of tonnage capacity of ship multiplied by the slab rate.

LESSON ROUND UP

- The term '**Hindu undivided family**' has not been defined in the Income-tax Act. However, in general parlance it means an undivided family of Hindus. Creation of a HUF is a God-gifted phenomenon. As soon as a married Hindu gets a child, a new HUF comes into existence. It is not at all necessary that every HUF must have joint property or family income.
- A Hindu Joint Family consists of Coparceners & members.
- The gross total income of the family for the relevant previous year shall be computed under the relevant heads (as per the provisions of the Income-tax Act) as it is computed for other assessee.
- 'Partition' signifies division of property. In the cases of property capable of physical division, share of each member is determined by making physical division thereof. It must be noted that a division of income without physical division of property does not amount to partition.
- **Partnership Firm:** Under Section 2(23) of the Income-tax Act, the terms "firm", "partner", and

“partnership” have the meanings respectively assigned to them in the Indian Partnership Act, 1932 and Limited Liability Partnership Act, 2008.

- As per the scheme, a partnership firm shall be assessed as a firm if the following conditions are satisfied:
 - The partnership is evidenced by an instrument i.e. partnership deed.
 - The individual shares of the partners are specified in that instrument.
 - A copy of the partnership deed certified by all the partners in writing (other than the minors) is submitted along with the return of income in respect of which assessment as a firm is first sought.
- As per Section 10(2A) of the Act, any person who is a partner of a firm which is assessed as such, his share in the total income of the firm **will not be included in computing his total income**. Partner includes a minor admitted to the benefits of partnership as per Section 2(23) of the Act.
- When all the partners in the predecessor firm are replaced by new partners in the successor firm, it is known as succession of one firm by another firm. If a firm is dissolved and some of the partners take over the firm's business or carry on a similar business with or without new partners, it would be a case of succession by a new firm .
- Where a change has occurred in the constitution of a firm on account of death or retirement, the firm is not entitled to carry forward and set off so much of the loss proportionate to the share of a retired or deceased partner as exceeds his share of profits, if any, in the firm in respect of the previous year.
- **Alternate Minimum Tax:** From the assessment year 2012-13 onwards, where the regular income tax payable for a previous year by a person other than a company is less than the alternate minimum tax payable for such previous year then the adjusted total income shall be deemed to be the total income such person for such previous year and it shall be liable to pay income tax on such adjusted total income @ 18.5% plus education & SHEC @ 3%.
- **Association of persons:** “Association of persons” means an association in which two or more persons join in a common purpose or common action to produce income, profits or gains.
- For the formation of an AOP the association need not necessarily be on the basis of a contract, consent and understanding may be presumed.
- Section 167B makes the following provisions as regards the incidence of charge of tax on the association of persons.
 - **Where shares of members are determinate** In this case, tax is chargeable on the income of the association of persons at the same rate as applicable to an individual. However, where the total income of any member of the association of persons for the previous year (excluding his share of income from the association of persons) exceeds the maximum amount not chargeable to tax in the case of an individual, tax will be charged on the total income of the AOP at the maximum marginal rate of 30%, i.e. the highest slab applicable to an individual.
 - **Where the shares of the members are indeterminate** In these cases, tax will be charged on the total income of the AOP at the maximum marginal rate, that is, the rate of tax as well as surcharge, if any, applicable to the highest slab of income in the case of an individual as specified in the Finance Act of the relevant year
- Section 67A seeks to provide for the method of computing a member's share in the income of an association of persons or a body of individuals, wherein the shares of the members are determinate, in the same manner as provided for in Sub-sections (1) to (3) of Section 67 for computing a partner's share in a firm.

- **Co-operative Society** means a co-operative society registered under the Co-operative Societies Act, 1912, or under any other law for the time being in force in any State for the registration of co-operative societies.
- The income of a co-operative society is computed in the same manner as provided for other assessees.
- Section 80P provides for certain deductions from the gross total income of a Co-operative Society.
- To make the Indian shipping industry more competitive, a tonnage tax scheme for taxation of shipping profits has been introduced. Many maritime nations have introduced tonnage based taxation. Under this scheme, of presumptive taxation whereby the notional income arising from the operation of a ship is determined based on the tonnage of the ship.

SELF TEST QUESTIONS

These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation.

MULTIPLE CHOICE QUESTIONS

1. According to Hindu law, a Joint Hindu family may consist of
 - Persons lineally descended from a common ancestor
 - Married daughters of a deceased person
 - Widows of the members of the family
 - All the above
2. Which member of the family can demand partition in the property?
 - All coparceners
 - Son
 - Mother
 - Wife
3. What is the rate of income-tax applicable to a co-operative society for the Assessment Year 2013-14 when total income does not exceed ₹ 10,000?
 - 8% of the total income
 - 9% of the total income
 - 10% of the total income
 - 11% of the total income

TRUE AND FALSE

1. Creation of a HUF is a legal phenomenon.
2. Every person who was at the time of a discontinuance or dissolution of a AOP shall jointly and severally be liable for the amount of tax, penalty or other sum payable.
3. The subsidy given by the government to a co-operative society for meeting managerial expenses and admission fee collected by the society is liable to tax.
4. 'Association of Persons' means an association in which two or more persons join in a charitable trust for the well-being of society.

5. As per Section 10(2A) of the Act, for any person who is a partner of a firm which is assessed as such, his/her share in the total income of the firm will be included in computing his/her total income.

ELABORATIVE

1. What are the provisions relating to assessment of a HUF after its partition?
2. Explain the terms 'Partition', 'Partial Partition', and 'Co-larceners'.
3. Answer the following questions:
 - (a) Can a widow be the Karta of a H.U.F.?
 - (b) Can a H.U.F. be a partner in a firm?
 - (c) Can there be a Hindu undivided family with a sole surviving male member and widows?
 - (d) Can uncle and nephew form a H.U.F.?
 - (e) Can a junior member act as the Karta of a joint Hindu family?
4. What is the New Scheme of Taxation of a firm?
5. Explain in brief the condition for allowability of deduction of interest to a partner.
6. Explain the difference between the change in constitution and succession of a firm. Illustrate.
7. What is meant by Association of Persons? How is it formed?
8. Discuss tax liability of an Association of Persons.
9. Discuss tax liability of the members of Association of Persons. State the circumstances, if any, under which their share of income from an association of persons is not chargeable to tax.
10. Explain the following under the Income-tax Act:
 - (a) "Co-operative Society".
 - (b) "Urban Consumers" Co-operative Society".
11. Explain the deductions which are allowed under Section 80P to arrive at the total income of a co-operative society.

ANSWERS/HINTS

Multiple Choice Questions

1. (d); 2. (a); 3. (c);

True and False

1. False; 2. True; 3. True; 4. False; 5. False;

SUGGESTED READINGS

- | | |
|--------------------------------|---|
| 1. Dr. V.K. Singhania | : Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi. |
| 2. Girish Ahuja and Ravi Gupta | : Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi. |

Lesson 8

Computation of Tax Liability of Companies

LESSON OUTLINE

- Constitutional provisions
- Meaning of Company under section 2(17) of the Income-tax Act
- Categories of companies under the Income-tax Act, 1961
 - Indian company
 - Domestic company
 - Foreign company
 - Company in which public are substantially interested (a widely-held company)
 - Closely held company
- Tax incidence under Income-tax Act, 1961
- Rates of Income Tax for Assessment Year 2014-15
- Minimum Alternate Tax (MAT)
- Dividend Distribution Tax u/s 115-O
- Taxation of Foreign Dividends (Section 115BBD)
- Lesson Round Up
- Self Test Questions

LEARNING OBJECTIVES

In the previous lessons we have learned the tax provisions of persons not being the company. Here, we will go through the income tax provisions of corporate. Company is also defined as person and liable to pay taxes on the income earned in the previous year. Section 2(17) of the Act, has defined the company as domestic company and foreign company. Now, the question arises why the foreign companies are required to pay tax in India. As it is discussed in earlier lessons that tax liability is determined on the basis of residential status and source of income, therefore the tax liability of company is also determined on the basis of residency and source of income accrue or arise in India.

At the end of this lesson, you will learn :

- what are the constitutional provisions for companies with regard to income tax,
- which companies are domestic and which are foreign companies,
- when the provisions of Minimum Alternate Tax shall be applicable
- what are the provisions of dividend distribution tax
- what is the taxability of Foreign dividends.

Income tax being direct tax is a major source of revenue for the Central Government. The entire amount of income tax collected by the Central Government is classified under the head: (a) Corporation Tax (Tax on the income of the companies) and (b) Income Tax (Tax on income of the non-corporate assesses).

CONSTITUTIONAL PROVISIONS

Under the Constitution of India, the legislative fields in entries 85 and 86 of the Union List in the Seventh Schedule specify Corporation tax and taxes on capital value of the assets, exclusive of agricultural land of individuals and companies. A tax on capital value of assets is a composite tax on the totality of all the assets owned by the company.

Article 366(6) of the Constitution defines corporate tax as follows:

Corporate tax means any tax on income, so far as that tax is payable by companies and is a tax in case the following conditions are fulfilled:

- (a) that it is not chargeable in respect of agricultural income;
- (b) that no deduction in respect of tax paid by companies is by any enactments which may apply to the tax authorised to be made from dividends payable by the companies to individuals;
- (c) that no provision exists for taking the tax so paid into account for computing for the purposes of Indian income tax, the total income of individuals receiving such dividends, or in computing the Indian income tax payable by, or refundable to, such individuals.

MEANING OF COMPANY UNDER SECTION 2(17) OF THE INCOME-TAX ACT

As per section 2(17), company means:

- (i) any Indian company, or
- (ii) any body corporate incorporated by or under the laws of a country outside India, or
- (iii) any institution, association or body which is or was assessable or was assessed as a company for any assessment year under the Indian Income Tax Act, 1922 (11 of 1922) or was assessed under this Act, as a company for any assessment year commencing on or before April 1, 1970; or
- (iv) any institution, association or body, whether incorporated or not and whether Indian or non-Indian, which is declared by general or special order of the CBDT to be a company.

Provided that such institution, association or body shall be deemed to be a company only for such assessment year or assessment years (whether commencing before the 1st day of April 1971, or on or after that date) as may be specified in the declaration.

CBDT Order

In cases where the CBDT specifies any association or body to be a company, it is essential that the order of the Board is taken to be valid only in respect of the assessment year or years specifically mentioned in the Board's order. The Board's power is specifically made exercisable in respect of past assessment year. In other words, the declaration of the Board does not automatically mean that the association or body would continue to be treated as a company for all purposes and for all assessment years. Whilst declaring any institution, association or body as a company, the Board has also to justify itself that they have characteristics as would generally enable them to be recognized as companies in common parlance as sometimes, such a declaration may be sought for by institutions for avoiding taxes.

The power of the to declare any foreign association or body as a company is absolute and unqualified and the Board would normally declare such association or body to be a 'company' only after taking into consideration the benefit to the revenue (Section 119 read together with Section 295 of the Income Tax Act, 1961).

Liquidating Company

A Company in liquidation is also a “company” and the Income tax authorities are entitled to call upon the liquidator to make a return of the company’s income. Likewise, penalty proceedings can also be initiated against a company in liquidation for a default committed prior to liquidation. Thus, the expression Company as defined in the Income Tax Act has a much wider connotation than what is normally understood by a ‘Company’ under the Companies Act.

Companies established under section 25 of the Companies Act, 1956

In order to be regarded as a taxable entity under the Income Tax Act, 1961, it is not essential that the company must always have a share capital and must have been formed with a profit motive. Even companies having no share capital and those, which are limited by guarantee, are assessable as companies for income-tax purposes even if such companies may have been formed without any profit motive and registered under Section 25 of the Companies Act 1956 (e.g. Chambers of Commerce etc.). Under Section 28 (iii) of the Income tax Act, 1961, trade, professional or similar associations are liable to tax in respect of the income they derive from rendering of specific services to their members. Accordingly, in respect of specific services to their members, such entities, even if they are non-profit making, would become liable to tax under the Income tax Act as a company in respect of their income from business although they may not have been specifically formed to carry on any business with a view to make profit. A statutory corporation established under the Act of Parliament, Government companies and the State Government companies who carry on a trade or business would also be treated as a company for all purposes of income tax.

Discontinuance of Business

A company or for that matter, any assessee who discontinued their business are statutorily required to intimate to the Assessing Officer within 15 days (Section 176 of the Income Tax Act, 1961).

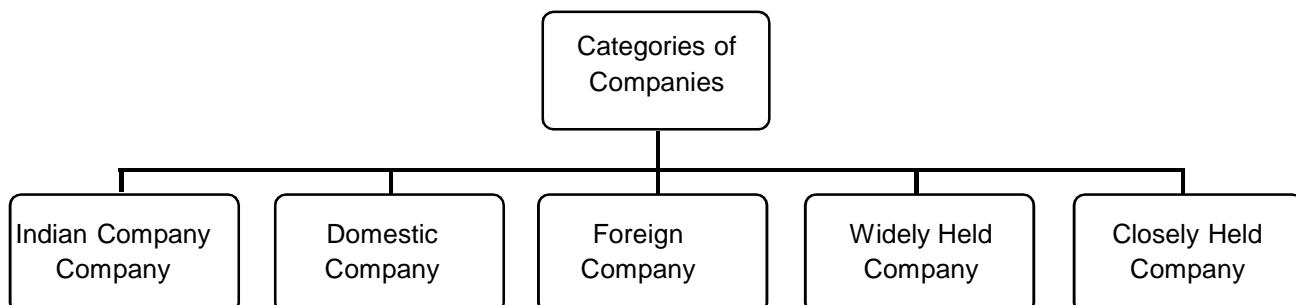
Assessment of Companies

For assessment to income tax, each company is assessed separately although the companies might be inter-related or inter-connected; for instance, holding and subsidiary companies must be assessed separately to Income tax in respect of the profits made by each of them since they have a separate and distinct legal existence.

The Supreme Court in the case of *Mrs. Bacha F. Guzdar v. CIT* (1955) 27 ITR 1(SC) has held that dividend received from a company earning agricultural income is not an agricultural income in the hands of the shareholders and therefore does not qualify for exemption under Section 10 (1) which grants exemption to agricultural income.

CATEGORIES OF COMPANIES UNDER THE INCOME TAX ACT, 1961

In continuation of our, earlier discussion on definition of company, we will now discuss broadly the different categories of companies:



Let us now discuss these in detail from taxation point of view.

Indian Company

Section 2(26) of the Income Tax Act, 1961 defines the expression 'Indian Company' as a company formed and registered under the Companies Act, 1956 and includes:

- (a) a company formed and registered under any law relating to companies formerly in force in any part of India (other than the State of Jammu and Kashmir, and the Union Territories specified in (e) below);
- (b) any corporation established by or under a Central, State or Provincial Act;
- (c) any institution, association or body which is declared by the Board to be a company under Section 2(17) of the Income Tax Act, 1961;
- (d) in the case of State of Jammu & Kashmir, any company formed and registered under any law for the time being in force in that State; and
- (e) in the case of any of the Union Territories of Dadra and Nagar Haveli, Goa, Daman and Diu and Pondicherry, a company formed and registered under any law for the time being in force in that Union Territory;

Provided that the registered or, as the case may be, principal office of the company, corporation, institution, association or body in all cases is in India.

From the above definition, it may be seen that statutory corporations as well as government companies are automatically treated as Indian companies for purposes of the Income Tax Act, 1961. The definition of an Indian company has been specifically given under the Income Tax Act, 1961 because of the fact that Indian companies are entitled to certain special tax benefits under this Act. It must be noted that all companies falling within the definition given in Section 2(17) of the Act are not necessarily Indian companies whereas all Indian companies are companies within the meaning of Section 2(17) of the Act.

"Infrastructural capital company" as defined under Section (26A) means such company which makes investments by way of acquiring shares or providing long-term finance to any enterprise or undertaking wholly engaged in the business referred to in Sub-section (4) of Section 80-IA or Sub-section (1) of Section 80-IAB or an undertaking developing and building a housing project referred to in Sub-section (10) of Section 80-IB or a project for constructing a hotel of not less than three-star category as classified by the Central Government or a project for constructing a hospital with at least one-hundred beds for patients.

Domestic Company

Section 2(22A) of the Income Tax Act, 1961, defines domestic company as an Indian company or any other company which, in respect of its income liable to tax under the Income Tax Act, has made the prescribed arrangements for the declaration and payment within India, of the dividends (including dividends on preference shares) payable out of such income.

From this definition, it is clear that all Indian companies are domestic companies while all domestic companies need not necessarily be Indian companies. In other words, a non-Indian company would be considered as a domestic company if it makes the prescribed arrangements for the declaration and payment of dividends in India on which tax is deductible under Section 194. These arrangements are as follows:

- (i) the share register of the company concerned, for all its shareholders, shall be regularly maintained at its principal place of business within India in respect of any assessment year from a date not later than the first day of April of such year.
- (ii) the general meeting for passing the accounts of the previous year relevant to the assessment year 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 shareholders.

Foreign Company

Section 2(23A) of the Income tax Act defines foreign company as a company, which, is not a domestic company. However, all non-Indian companies are not necessarily foreign companies. If a non-Indian company has made the prescribed arrangements for declaration and payments of dividends within India, such a non-Indian company must be treated as a “domestic company” and not as a “foreign company”.

Test Your Knowledge



1. A foreign company may be treated as domestic company under the Income Tax Act, 1961. True or False?

COMPANY IN WHICH PUBLIC ARE SUBSTANTIALLY INTERESTED (A WIDELY-HELD COMPANY)

Section 2(18) of the Income Tax, Act defines the expression “company in which the public are substantially interested”.

A company is said to be one in which public are substantially interested in the following cases, namely –

- (i) If it is a company owned by the Government or the Reserve Bank of India or in which not less than 40 per cent of the shares, whether singly or taken together, are held by the Government or the Reserve Bank of India or a corporation owned by the Reserve Bank of India; or
- (ii) If it is a company which is registered under Section 25 of the Companies Act, 1956; or
- (iii) If it is a company, having no share capital and if, having regard to its objects, the nature and composition of its membership and other relevant considerations, it is declared by an order of the Board (CBDT) to be a company in which the public are substantially interested. However, such a company shall be deemed to be one in which the public are substantially interested only for the assessment year(s) as may be specified in the declaration; or
- (iv) If it is a company which carries on, as its principal business, the business of acceptance of deposits from its members and which is declared by the Central Government under Section 620A of the Companies Act, 1956 to be a Nidhi or Mutual Benefit Society; or
- (v) If it is a company in which shares carrying not less than 50 per cent of the voting power have been allotted unconditionally to or acquired unconditionally by, and are throughout the relevant previous year beneficially held by, one or more cooperative societies; or
- (vi) If it is a company which is not a private company as defined in Section 3 of the Companies Act, 1956 and equity shares of the company (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in the profits, i.e. preference shares) were, as on the last day of the relevant previous year, listed in a recognised stock exchange in India;
- (vii) If it is a company which is not a private company within the meaning of the Companies Act, 1956, and the shares in the company (not being shares entitled to a fixed rate of dividend whether with or without a further right to participate in profits) carrying not less than 50 per cent (40 per cent in case of an industrial company) of the voting power have been allotted unconditionally to, or acquired unconditionally

by, and were throughout the relevant accounting year beneficially held by (a) the Government, or (b) a corporation established by a Central or State or Provincial Act, or (c) any company in which the public are substantially interested or a wholly owned subsidiary company.

Industrial Company means an Indian company where business consists mainly in the construction of ships or in the manufacture or processing of goods or in mining or in the generation or distribution of electricity or any other form of power.

It may be noted that, a public company under the Companies Act, 1956 need not necessarily fall within the meaning of a company in which the public are substantially interested under the Income-tax Act, 1961 because a public company under the Companies Act, 1956 may be considered as one in which the public are not substantially interested under the Income-tax Act, 1961 after considering the nature and extent of shareholding.

Closely held company

A Company in which the public is not substantially interested is known as a closely held company.

The distinction between a closely held and widely held company is significant from the following viewpoints.

- (i) Section 2(22) (e), which deems certain payments as dividend, is applicable only to the shareholders of a closely-held company; and
- (ii) A closely held company is allowed to carry forward its business losses only if the conditions specified in Section 79 are satisfied.

TAX INCIDENCE UNDER INCOME TAX ACT, 1961

As you know, the incidence of Income tax depends upon the residential status of a company in India during the relevant previous year. A Company may be either resident or non-resident in India, i.e., company can not be ordinary or non-ordinary resident.

According to Section 6(3) of the Act, a company is said to be resident in India (resident company) in any previous year, if:

- (i) It is an Indian company; or
- (ii) During that year, the control and management of its affairs is situated wholly in India.

If one of the above two tests is not satisfied the company would be a non-resident in India during that previous year.

According to Section 5(1) of the Act, the total income of a resident company would consist of:

- (i) income received or deemed to be received in India during the previous year by or on behalf of such company;
- (ii) income which accrues or arises or is deemed to accrue or arise to it in India during the previous year;
- (iii) income which accrues or arises to it outside India during the previous year.

It is important to note that under clause (iii) only income accruing or arising outside India is included. Income deemed to accrue or arise outside India is not includable in the hands of residents. Hence, net dividends received from foreign companies are includable in income and not the gross dividends [CIT v. Shaw Wallace & Co. Ltd. (1981) 132 ITR 466].

In this context, the Calcutta High Court had followed the Supreme Court's decision in Commissioner of Income-tax v. Clive Insurance Co. Ltd. (1978, 113 ITR 636) holding that the assessee could be said to have paid Income Tax in U.K. by deduction or otherwise, in respect of the net dividend so as to be eligible for relief contemplated

by Section 49D of the Indian Income Tax Act, 1922. Following the Supreme Court's decision, the Bombay High Court held in the case of Commissioner of Income tax v. Tata Chemicals Ltd. (1986, 162 ITR 556) that the assessee was entitled to double taxation relief under Section 91 of the Income Tax Act, 1961 in respect of dividends from the United Kingdom. Following its decision in the case of Shaw Wallace & Co. Ltd. (supra), the Calcutta High Court held in the case of the same assessee (1983, 143 ITR 207) that dividends from foreign companies are to be assessed not on the gross amount of the dividends but on the gross amount of the dividends less tax deducted there from in foreign countries. In other words, only the net foreign dividends are to be included in the total income of a resident assessee under Section 5(1)(c) of the Income Tax Act, 1961.

Under Section 5(2) of the Act, the total income of non-resident company would consist of:

- (i) Income received or deemed to be received in India in the previous year by or on behalf of such company;
- (ii) Income which accrues or arises or is deemed to accrue or arise to it in India during the previous year.

The decision of the Supreme Court in the case of Standard Triumph Motor Co. Ltd. v. CIT (1993) 201 ITR 391 to the effect that when an Indian resident passes an entry crediting a non-resident with amount payable to him, that would tantamount to the latter receiving income in India, is having grave consequences. In this case, the royalty payable to non-resident in pound sterling was credited to the non-residents accounts in the books of the assessee. The Supreme Court held that the plea to accept royalty income in U.K. was immaterial because the amount was available for the use of the non-resident in India in any manner he liked. Hence, the income was received in India. In the wake of this decision, non-residents who have all along been held to be not liable to Indian Income-tax if the contract was signed outside India, executed outside India and paid for outside India could well fall into the Indian-tax net, should their clients/customers credit them for the amount due before making payments to them outside India. In other words, a non-resident's tax liability depends upon the accounting entry passed by his client customer.

RATES OF INCOME TAX FOR ASSESSMENT YEAR 2014-15

<i>Domestic companies</i>	
For income other than long term capital gains	30% of total income
On short term capital gains emanating from transfer of a short term capital asset being an equity share or unit of an equity oriental fund	15%
On long-term capital gains emanating from transfer of a long term capital asset	20%
<i>Foreign companies</i>	
In the case of a company other than a domestic company –	
On so much of the total income as consists of – royalties received from Government or an Indian concern in pursuance of an agreement made by it with the Government or the Indian concern after the 31st day of March, 1961 but before the 1st day of April, 1976; or fees for rendering technical services received from Government or an Indian concern in pursuance of an agreement made by it with the Government or the Indian concern after the 29th day of February, 1964 but before the 1st day of April, 1976, and where such agreement has, in either case, been approved by the Central Government.	50%
On other incomes	40%

Note: 1. On Domestic Company Surcharge is applicable @ 5% in case total income exceeds ₹ 1 Crore and @ 10% in case total income exceeds ₹ 10 Crore.

2. In case of foreign companies : Surcharge @ 2% where total income exceeds ₹ 1 Crore and @ 5% where total income exceeds ₹ 10 Crore shall be applicable.

3. Plus Education Cess @ 2% and Secondary & Higher Education Cess @ 1% on tax & surcharge

Marginal Relief: In case of the above assessees having a total income exceeding ₹ 1 crore, marginal relief would be provided to ensure that the additional income-tax payable including surcharge, on the excess of income over ₹ 1 crore is limited to the amount by which the income is more than ₹ 1 crore.

In other words, marginal relief = Tax on total income (plus surcharge) – [Tax on total income of ₹ 1 crore + (Total Income – ₹ 1 crore)], if positive.

Note: For more details, please refer Lesson No. 9 relating to non-residents including foreign company.

MINIMUM ALTERNATE TAX (MAT)

Section 115J which was a special provision applicable to a company if its total income as computed under the Income tax Act was less than thirty per cent of its book profit was introduced with effect from 1.4.1988 but was discontinued with effect from 1.4.1991. It was revived as Section 115JA with effect from 1.4.1997 as a provision deeming total income equal to thirty per cent of book profit of companies referred to earlier. This provision was also discontinued with effect from 1.4.2001 but was substituted by Section 115JB effective from the same date. This provision follows concept of minimum alternate Tax.

As provided out in the Explanatory Memorandum to the Finance Bill, 2000, the Minimum Alternate Tax had been levied from the assessment year 1997-98 as the number of zero tax companies and companies paying marginal tax had proliferated. The efficacy of that provision, however, had declined in view of the exclusions of various sectors from the operation of MAT and the tax credit systems.

Hence, in its place the new provisions of Section 115JB were inserted which are simpler in application. They provide that all companies having book profits under the Companies Act shall have to pay a minimum alternate tax at a rate of 18.5% (as amended). These provisions are applicable to all corporate entities.

According to this section, if the income tax payable by a company on its total income as computed under the Income Tax Act in respect of any previous year relevant to the assessment year commencing on or after the 1st day of April, 2012, is less than 18.5% of such book profit plus surcharge plus education cess then such book profit shall be treated as total income of the company and the tax payable for the relevant previous year shall be deemed to be 18.5% of such book profit. This non-absolute provision will override any other provision of the Income Tax Act.

Thus, where the Income-tax payable is less than 18.5% of Book Profit, such book profit will be deemed to be total Income and Income Tax will be payable @ 18.5% on such Book Profit.

Such company assessee has to prepare Profit & Loss A/c in accordance with the provisions of Part I and II of Schedule VI of the Companies Act, 1956.

Sub-section (2) of this section requires the company in this case will prepare its profit and loss account for the relevant previous year in accordance with the provisions of Parts II of Schedule VI of the Companies Act, 1956. However, while preparing the annual accounts including profit and loss account –

- (a) the accounting policies;
- (b) the accounting standards followed for preparing such accounts including profit and loss accounts; and
- (c) the method and rates adopted for calculating the depreciation,

shall be the same as have been adopted for the purpose of preparing such accounts including profit and loss account and laid before the company at its annual general meeting in accordance with the provisions of Section

210 of the Companies Act, 1956. But where the company has adopted or adopts the financial year, which is different from the previous year under the Income Tax Act, (a), (b) and (c) aforesaid shall correspond to the accounting policies, accounting standards and the method and rates for calculating the depreciation which have been adopted for preparing such accounts including profit and loss account for such financial year or part of such financial year falling within the relevant previous year.

As per section 115JB, every company is required to prepare its accounts as per Schedule VI of the Companies Act, 1956. However, as per the provisions of the Companies Act, 1956, certain companies, e.g. Insurance, Banking or Electricity Company, are allowed to prepare their profit and loss account in accordance with the provisions specified in their regulatory Acts.

In order to align the provisions of Income-tax Act with the Companies Act, 1956, with effect from assessment year 2013-14, section 115JB has been amended to provide that the companies which are not required under section 211 of the Companies Act to prepare their profit and loss account in accordance with the Schedule VI of the Companies Act, 1956, profit and loss account prepared in accordance with the provisions of their regulatory Acts shall be taken as a basis for computing the book profit under section 115JB.

However, a sub-section (5A) has been inserted to section 5, w.r.e.f A.Y. 2001-02, which provides that the MAT provisions shall not apply to any income accruing or arising to a company from life insurance business.

Meaning of “Book Profit”

As per Explanation below Sub-section (2), “Book Profit” means the net profit as shown in the profit and loss account for the relevant previous year prepared under this sub-section as increased by the following amounts:

- (a) the amount of Income tax paid or payable, and the provision therefor; or

The amount of income-tax shall include:

- (i) any tax on distributed profits under Section 115O or on distributed income under section 115R;
- (ii) any interest charged under this Act; and
- (iii) Surcharge, Education Cess and SHEC on Income-tax, if any, as levied by the Central Acts from time to time.
- (b) the amounts carried to any reserves, by whatever name called other than reserve specified under Section 33AC, i.e, shipping reserve; or
- (c) the amount or amounts set aside to provisions made for meeting liabilities, other than ascertained liabilities, (i.e. unascertained liabilities); or
- (d) the amount by way of provision for losses of subsidiary companies; or
- (e) the amount or amounts of dividends paid or proposed; or
- (f) the amount or amounts of expenditure relatable to any income to which Section 10 (other than the provisions contained in clause 38) or Section 11 or Section 12 apply.
- (g) the amount of depreciation.
- (h) the amount of deferred tax and provisions therefore (inserted by Finance Act, 2008 with retrospective effect from 1.4.2001).
 - (i) the amount or amounts set aside as provision for diminution in the value of any asset (w.r.e.f. 1.4.2001) e.g. provision for bad and doubtful debts and provision for impairment losses.
 - (j) the amount standing in revaluation reserve relating to revalued asset on the retirement or disposal of such asset.

If any of the above amount referred in clauses (a) to (i) is debited to the profit and loss account or if any amount referred in clause (j) is not credited to the profit and loss account, and shall be reduced by the following amounts:

- (i) the amount withdrawn from any reserves or provisions if any such amount is credited to the profit and loss account;

Provided that, where this section is applicable to an assessee in any previous year, the amount withdrawn from reserves created or provisions made in a previous year relevant to the assessment year commencing on or after the 1st day of April, 1997 shall not be reduced from the book profit unless the book profit of such year has been increased by those reserves or provisions (out of which the said amount was withdrawn) under this Explanation or Explanation below second proviso to Section 115JA, as the case may be; or

In other words, if amount is withdrawn from provisions/reserve not allowed as deduction earlier, it will not be added (taxed) again ; however in any other case the withdrawal will be taxed.

- (ii) the amount of income to which any of the provisions of Section 10 (other than the provisions contained in clause 38) or Section 11 or Section 12 apply, if any such amount is credited to the profit and loss account; or
- (iia) the amount of depreciation debited to the profit and loss account (excluding the depreciation on account of revaluation of assets); or
- (iib) the amount withdrawn from revaluation reserve and credited to the profit and loss account, to the extent it does not exceed the amount of depreciation on account of revaluation of assets referred to in Clause (iia); or
- (iii) the amount of loss brought forward or unabsorbed depreciation, whichever is less, as per books of account. For the purposes of this clause, the loss shall not include depreciation. Therefore, in a case where an assessee has shown profit in a year, but after adjustment of depreciation it results profit or loss, no adjustment in book profit is allowed; or
- (iv) the amount of profits of sick industrial company for the assessment year commencing on and from the assessment year relevant to the previous year in which the said company has become a sick industrial company under Sub-section (1) of Section 17 of the Sick Industrial Companies (Special Provisions) Act, 1985 and ending with the assessment year during which the entire net worth of such company becomes equal to or exceeds the accumulated losses. "Net Worth" shall have the meaning assigned to it in Clause (ga) of Sub-section (1) of Section 3 of the Sick Industrial Companies (Special Provisions) Act, 1985.
- (v) The amount of deferred tax, if any such amount is credited to the profit and loss account.

The following points should also be noted in this context:

1. Nothing contained in Sub-section (1) shall affect the determination of the amounts unabsorbed depreciation under Section 32(2), business loss u/s 72(1), speculation loss u/s 73, capital loss u/s 74 and loss u/s 74A in relation to the relevant previous year to be carried forward to the subsequent year or years.
2. Every company to which this section applies, shall furnish a report in the prescribed form from an accountant as defined in the Explanation below Sub-section (2) of Section 288, certifying that the book profit has been computed in accordance with the provisions of this section along with the return of income filed under Sub-section (1) of Section 139 or along with the return of income furnished in response to a notice under Clause (I) of Sub-section (1) of Section 142.
3. Save as otherwise provided in this section, all other provisions of this Act shall apply to every assessee, being a company, mentioned in this section.
4. The provisions of this Section shall apply to the income accrued or arising on or after the 1st day of April, 2005 from any business carried on, or services rendered, by an entrepreneur or a Developer, in a Unit

or Special Economic Zone, as the case may be (amendment made by Finance Act, 2011 and shall be effective from Assessment Year 2012-13, earlier the MAT provisions does not apply to SEZ enterprises and SEZ developers).

1. Whether the provisions of MAT applicable to foreign companies or not?

Since 'company' defined u/s 2(17) includes any body corporate incorporated under the laws outside India, so foreign companies are also liable to MAT in respect of their income in India.

However, foreign companies shall not liable u/s 115JB without physical presence.

The Authority for Advance Ruling ("AAR") has delivered a ruling in the case of *Timken India Ltd. In re* (2005) 273 ITR 67 (AAR) where it holds that the provisions of section 115JB of the Income-tax Act, 1961 ("the Act") levying Minimum Alternate Tax ("MAT") on the book profit of a Company would not apply to a Foreign Company not having any physical presence in India. In this case, the AAR distinguished its earlier ruling of 1998 (234 ITR 828) wherein it had held that a foreign company would be subject to MAT provisions. The critical factor for distinguishing was on the basis that in the earlier ruling the applicant had a project office in India, which constituted a Permanent Establishment and was preparing its financial statements as required under Indian Companies Act, 1956. In order to comply with the requirement of MAT provisions regarding preparing Profit & Loss Account in accordance with the provisions of the Indian Companies Act, it is essential that the foreign company should have a place of business within India.

Similar view has been upheld by AAR in the recent ruling of *Praxair Pacific Ltd., In re* [2010] 326 ITR 276 (AAR)

2. Whether Assessing Officer (AO) has the power to examine correctness of net profits shown in P&L Account [Apollo Tyres Ltd. v. CIT (2002) 255 ITR 273 (SC)]

The AO does not have the power to question correctness of P&L A/c prepared by assessee and certified by the statutory auditors of the company as having been prepared in accordance with the provisions of Parts II and III of Schedule VI to the Companies Act, 1956. The AO does not have the jurisdiction to go behind the net profits shown in the P&L A/c except to the extent provided in the Explanation 1 to Section 115JB.

3. Interest u/s 234B is payable on failure to pay advance tax in respect of tax payable u/s 115JB. [CIT v. *Rolta India Ltd.* (2011) 330 ITR 470 (SC) and Circular No. 13/2001]

MAT Credit

MAT Credit for taxes paid as per Section 115JB in earlier years (in which MAT liability was more than tax liability as per normal provisions of the Act) is available in the Assessment year in which Tax payable on the total income computed under the normal provisions of this Act is more than tax payable u/s 115JB for that Assessment year.

MAT Credit to be set off in an AY = Regular Income tax – Minimum alternate tax

Credit of MAT in respect of excess paid under Section 115JB will be available and it can be carried forward for 10 assessment years.

DIVIDEND DISTRIBUTION TAX UNDER SECTION 115-O

A domestic company is liable to pay tax on the amounts distributed, declared or paid as dividend (whether interim or otherwise), it shall be payable @15% plus surcharge and education cess & SHEC in addition to the income tax payable.

The amount distributed, declared or paid as dividend may be out of accumulated or current year profits and the same shall exclude:

- (i) the amount of dividend, if any, received by the domestic company during the financial year, if such dividend is received from its subsidiary and,

- (a) where such subsidiary is a domestic company, the subsidiary has paid the tax which is payable under this section on such dividend; or
- (b) where such subsidiary is a foreign company, the tax is payable by the domestic company under section 115BBD on such dividend.

However, the same amount of dividend shall not be taken into account for reduction more than once.

Section 115BBD of Income Tax Act provides for taxation of gross dividends received by an Indian company from a specified foreign company (in which it has shareholding of 26% or more) at the rate of 15%.

The word dividend shall not include deemed dividend u/s 2(22)(e) i.e. loan or advance given by a closely held company to a substantial shareholder but include dividend u/s 2(22)(a), (b), (c) & (d).

Finance Act, 2011 insert a proviso to sub-section 6 of section 115-O by which the provisions of section 115-O shall also be applicable on an enterprise or undertaking engaged in developing, operating and maintaining a SEZ. The amount of such tax shall be deposited within 14 days from the date of:

- (a) declaration of dividend or
- (b) distribution of dividend or
- (c) payment of dividend

Whichever is earliest.

Taxation of Foreign Dividends (Section 115BBD)

Where the total income of an Indian company, for the previous year 2011-12, 2012-13 and 2013-14 includes any income by way of dividends declared, distributed or paid by a specified foreign company such income shall be chargeable to tax @15% and such income shall be reduced from the total income.

No deduction in respect of any expenditure or allowance shall be allowed to the assessee under any provision of this Act in computing its income by way of dividends.

- (i) "dividends" shall have the same meaning as is given to "dividend" in section 2(22) but shall not include sub-clause (e) thereof;
- (ii) "specified foreign company" means a foreign company in which the Indian company holds twenty-six per cent, or more in nominal value of the equity share capital of the company.

Assessment of Companies

Illustration

The net profit of RADHA RANI LTD. as per profit and loss account for the previous year 2013-2014 is ₹ 200 Lakhs after debiting/crediting the following items:-

- (i) Provisions for income tax: ₹ 25 Lakhs
- (ii) Provisions for deferred tax: ₹ 18 Lakhs
- (iii) Proposed Dividend: ₹ 20 Lakhs
- (iv) Depreciation debited to profit and loss account is ₹ 12 Lakh. This includes depreciation on revaluation of asset to the tune of ₹ 4 Lakh.
- (v) Profit from unit established in Special Economic Zone: ₹ 30 Lakh.
- (vi) Provisions for permanent diminution in value of investment ₹ 2 Lakhs.

Brought forward losses and unabsorbed depreciation as per books of the company are as follows:-

Previos Year	Brought Forward Loss (₹ in Lakhs)	Unabsorbed Depreciation (₹ in Lakhs)
2010-2011	2	5
2011-2012	—	3
2012-2013	10	2

**Compute book profit of the company under section 115JB
for the Assessment Year 2014-15**

Solution

Computation of book profit of RADHA RANI LTD. under section 115JB for the Assessment Year 2014-15.

Particulars	(₹ in Lakhs)	(₹ in Lakhs)
Net profit as per profit and loss account		200
<i>Add:</i> Provisions for Income Tax	25	
Provisions for deffered tax	18	
Proposed dividend	20	
Depreciation	12	
Provision for dimunation in value of Investment	<u>4</u>	79
<i>Less:</i> Depreciation (excluding depreciation on revaluation of assets)	8	
Aggregate of brought forward loss or unabsorbed depreciation, as per books of Past years whichever is less	10	(18)
Book Profit		<u>261</u>

Illustration

Sohan Lal Ltd. is closely held company engaged in manufacturing of insecticides and fertilizers. The value of plant and machinery owned by the company is ₹ 55 Lakh. Its profits and loss account for the year ended 31st March 2014 is as under :

Particulars	(₹)	(₹)
Domestic Sales	22,28,900	
Export Sales	5,96,100	
Other receipt	<u>4,00,000</u>	32,25,000
<i>Less:</i> Expenses		
Depreciation	4,46,000	
Salary and Wages	1,84,000	
Entertainment expenses	40,000	
Travelling expenses	86,000	

Miscellaneous expense	9,000
Income Tax	3,50,000
Wealth Tax	8,000
Outstanding Customs Duty	17,800
Provisions for unascertained liabilities	70,000
Proposed dividends	60,000
Consultation fees paid to a tax consultant	21,000
Salary and perquisites of Managing Director	1,80,000
Excise Duty of 2011-2012	<u>55,000</u>
Net Profit	15,26,800
	16,98,200

The assesses claims the following as deductions:

- (a) Deduction under Section 80-IB (30% of ₹ 16,98,200)
- (b) Excise duty pertaining to 2011-12 paid during 2013-14 is ₹ 55,000
- (c) Depreciation under Section 32 is ₹ 5,36,000

The following further particular are furnished

	<i>For Tax Purposes</i>	<i>For Accounting Purpose</i>
	₹	₹
Brought forward loss of 2011-12	11,80,000	9,10,000
Unabsorbed depreciation	NIL	2,45,00

Calculate the Tax Liability of the company.

Solution

Calculation of book profit under section 115JB

Net Profit as Per Profit & loss Account	16,98,200
	₹

Add:

Income-tax	3,50,000
Provision for unascertained liabilities	70,000
Proposed dividend	<u>60,000</u>

Less :

Unabsorbed depreciation	<u>2,45,000</u>
Book Profit	<u>19,33,200</u>

Computation of taxable income

Net Profit as per Profit and Loss Account	16,98,200
	₹

Add:

Income Tax	3,50,000
Wealth Tax	8,000
Outstanding custom duty	17,800

Provision for unascertained liability	70,000	
Proposed dividend	<u>60,000</u>	<u>5,05,800</u>
		22,04,000
<i>Less</i> : Depreciation (i.e. ₹ 5,36,000 – 4,46,000)		<u>90,000</u>
Balance		21,14,000
<i>Less</i> : Deductions		
Under Section 80-IB (i.e. 30% of 16,98,200)		<u>5,09,460</u>
Total Income (rounded off)		<u>16,04,540</u>
<i>Computation of Tax Liability</i>		
Total Income		<u>16,04,540</u>
Tax on Net Income @ 30%	4,81,362	
<i>Add</i> : Surcharge	<u>Nil</u>	
Tax liability	4,81,362	
Add: EC & SHEC @ 3%	<u>14,400</u>	
Total Tax Liability	<u>4,95,802</u>	
18.5% of Book Profit	3,57,642	
<i>Add</i> : Surcharge	<u>Nil</u>	
Tax liability	3,57,642	
<i>Add</i> : EC&SHEC @3%	<u>10,729</u>	
Tax	<u>3,68,371</u>	

Minimum Alternate tax @ 18.5% of Book Profit is less than tax liability calculated as per the normal provisions of Income Tax Act, 1961. Therefore, company shall be liable to pay ₹ 4,95,802.

LESSON ROUND UP

- Article 366(6) of the Constitution defines corporate tax.
- As per section 2(17) of the Income Tax Act, Company means any Indian Company, or any body corporate incorporated by or under the laws of a country outside India, or any institution, association or body which is or was assessable or was assessed as a company for any assessment year under the Indian Income Tax Act, 1922 (11 of 1922) or was assessed under this Act, as a company for any assessment year commencing on or before April 1, 1970; or any institution, association or body, whether incorporated or not and whether Indian or non-Indian, which is declared by general or special order of the CBTD to be a company.
- Companies under the Income Tax Act are companies in which the public are substantially interested also referred to as widely-held companies and companies in which public are not substantially interested and also referred to as closely held company.
- Minimum Alternate Tax (“MAT”) on the book profit of a Company would not apply to a Foreign Company not having any physical presence in India.

- A domestic company is liable to pay tax on the amounts distributed, declared or paid as dividend (whether interim or otherwise), it shall be payable @ 15% plus surcharge @ 5% and education cess and SHEC @3% in addition to the income tax payable.
- Section 115BBD provides for taxing foreign dividends received from a foreign company at the rate of 15% plus surcharge @5% and education cess and SHEC @ 3%.

SELF TEST QUESTIONS

These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation.

MULTIPLE CHOICE QUESTIONS

1. “Book Profits” means the net profit as shown in the profit and loss account for the relevant previous year prepared under this sub-section as increased by;
 - (a) The provision for income tax
 - (b) Proposed Dividend
 - (c) Depreciation
 - (d) All the above
2. A company is said to be resident in India in any previous year, if:
 - (a) It is an Indian Company
 - (b) The control and management is wholly situated in India
 - (c) Either it is a Indian company or the control and management is wholly situated in India
 - (d) It is both an Indian Company and the control and management is wholly situated in India.
3. MAT Rate is _____% of book profit as per the Finance Act, 2012:
 - (a) 10
 - (b) 18
 - (c) 18.5
 - (d) 20
4. Credit of Minimum Alternate Tax (MAT) in respect of excess amount of tax paid under section 115JB could be carried forward for-
 - (a) 8 Assessment Year
 - (b) 5 Assessment Year
 - (c) 7 Assessment Year
 - (d) 10 Assessment Year

ELABORATIVE

1. What do you understand by “Book Profit” in the context of Minimum Alternate Tax.
2. Define the following keeping in view the points involved while planning tax:
 - (a) Indian Company
 - (b) Domestic Company

- (c) Foreign Company
- (d) Company in which public is substantially interested.
- (e) Closely-held Company.
3. Explain the significance of classification of companies under the Income tax Act, 1961 and their impact on the tax liability.
 4. Explain how is the residential status of a company determined under the Income tax Act, 1961.
 5. Explain how (i) the scope of tax liability on total income and, (ii) the rate of the tax applicable to a company are determined?
 6. Explain the concept of MAT and its rationale.
 7. When will the 'book profits' of a company deemed to be the total income of the company for the purposes of levy of MAT under section 115JB? Indicate briefly the points to be taken into account while preparing annual accounts for the purpose of MAT. The MAT does not apply to foreign companies operating in India. Do you agree? Give reasons.
 8. What is the quantum of MAT for a 'domestic company' and 'foreign company'?
 9. The cascading effect of dividend distribution tax is minimised in the case of holding and subsidiary companies. Discuss.
 10. Distinguish between Domestic company and foreign company. Are they treated alike under the income-tax rate structure?

ANSWERS/HINTS

1. (d); 2. (c); 3. (c); 4. (d)

TEST YOUR KNOWLEDGE

1. True, A foreign company shall become a domestic company if it has made arrangements for the declaration and payment of dividends in India which is payable out of domestic income.

SUGGESTED READINGS

- | | | |
|---|---|--|
| 1. Dr. V.K. Singhania | : | Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi. |
| 2. Girish Ahuja and Ravi Gupta | : | Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi. |
| | | Professional Approach to Direct Taxes Law & Practice; Bharat Law House, New Delhi. |
| 3. Dr. V.K. Singhania & Dr. Kapil Singhania | : | Direct Taxes Law & Practice; Taxmann Publications Pvt. Ltd., New Delhi. |

Lesson 9

Computation of Tax Liability of Non-resident Assessee

LESSON OUTLINE

- Introduction
- Exemptions and Concessions to Non-residents
- Tax on income from Global Depository Receipts purchased in foreign currency or capital gains arising from their transfer
- Profits of non-residents from Occasional Shipping Business (Section 172)
- Special provision for computing profits and gains of the business of operation of aircraft in the case of non-residents (Section 44BBA)
- Determination of Income in certain cases (Rule 10)
- Mode of Assessment
- Recovery of Tax
- Computation of Tax
- Lesson Round Up
- Self Test Questions

LEARNING OBJECTIVES

In the early stages of development every country has to depend to some extent on foreign capital and foreign technicians for the industrial development of the country. The Government of India also has been extremely anxious to attract foreign capital and technical know-how. To attract these, certain tax concessions have been granted to foreign investors and technicians and the Government has plans to offer still more concessions in the near future. The foreign investors may be Indian Nationals who reside outside India and other foreign investors including corporations. A person who resides outside India is technically known as "non-resident". However, under Income Tax Act, the status of a person depends upon the residential status in India.

At the end of this lesson, you will learn;

- Who is Non-Resident
- What are General and special rates of tax
- Special Provisions for Non-Resident Indian
- Special provision for computing profits and gains of the business of operation of aircraft in the case of non-residents.
- Special provision for computing income by way of royalties, etc., in case of non-residents.
- Special provision for computing profits and gains of shipping business in the case of non-residents.
- Shipping business of non-residents.
- Deduction of head office expenditure in the case of non-residents.
- Recovery of tax in respect of non-resident from his assets.

Liability to pay tax in India does not depend on the nationality or domicile of the Tax payer but on his residential status. Residential Status is determined on the basis of physical presence i.e. the number of days of stay in India in any year.

INTRODUCTION

In the early stages of development every country has to depend to some extent on foreign capital and foreign technicians for the industrial development of the country. The Government of India also has been extremely anxious to attract foreign capital and technical know-how. To attract these, certain tax concessions have been granted to foreign investors and technicians and the Government has plans to offer still more concessions in the near future. The foreign investors may be Indian Nationals who reside outside India and other foreign investors including corporations. A person who resides outside India is technically known as "non-resident". The residential status of an individual does not depend upon the nationality or domicile of that person but it depends upon his stay in India during the previous year. In case of an assessee, other than an individual, the residence depends upon the place from which its affairs are controlled and managed. If the control and management of the affairs of a foreign company is, during the previous year, situated wholly in India, it shall be treated as resident in India. Where part of the control and management of the affairs of a foreign company is situated outside India, it shall be treated as a non-resident company.

Note: For details see Basis of Charge, Scope of Total Income and Residential Status Lesson 2.

Incomes Exempt in the hands of Non-Resident /Foreign Company [Section 10]

The following incomes are exempt in the hands of a non-resident or a foreign company:

- (a) Interest on Non Resident External Account [Section 10(4)(ii)]: In the case of an individual, any income by way of interest on moneys standing to his credit in a Non-Resident (External) Account in any bank in India in accordance with the Foreign Exchange Management Act, 1999 ('FEMA') is exempt.
Individual is a person resident outside India as defined in Section 2 of the FEMA or is a person who has been permitted by the Reserve Bank of India to maintain the aforesaid Account.
- (b) Tax payable on Royalty or FTS on behalf of foreign company: Tax payable, under the terms of the agreement, on Royalty or FTS on behalf of foreign company is exempt under section 10(6A).
 - Such foreign company receives such income from GOI or an Indian concern in pursuance of an agreement made before 1/6/2002.
 - Agreement must be in accordance with Industrial Policy or approved by the Central Government.
- (c) Tax payable on certain incomes on behalf of foreign company or NR: Tax payable on certain incomes (not being salary, royalty or FTS) on behalf of foreign company or a NR is exempt u/s 10(6B).
 - Income is earned in pursuance of agreement made before 1/6/2002 between CG and Government of foreign state/international organisation.
 - Tax is payable as per the agreement by the Government or Indian Concern.
- (d) Tax payable by Indian Company on behalf of foreign Govt. etc.: Tax payable, on behalf of foreign Govt. or foreign enterprises by, Indian company engaged in business of operation of aircraft, on income from leasing of aircraft etc. u/s 10(6BB).
 - The payment is as consideration for acquiring an aircraft / aircraft engine on lease under an agreement and not for providing spares, facilities or services in connection with the operation of a leased aircraft.
 - The agreement is entered after 31/3/2007 and is approved by the Central Government.
- (e) Royalty or FTS received by a specified foreign company: Royalty or FTS received by specified foreign company is exempt u/s 10(6C).

- Income is received under agreement entered into with Central Government for providing services in or outside India in projects related with security of India.
- (f) Lease rent paid for leasing aircraft Leasing rent paid for leasing aircraft by an Indian company engaged in business of operation of aircraft as a consideration for acquiring an aircraft or an aircraft engine on lease from Govt. of a foreign State or a foreign enterprise under an agreement is exempt under section 10(15A) in the hands of NR or foreign company.
 - The payment should not be for providing spares, facilities or services in connection with the operation of leased aircraft.
 - No exemption shall be available for agreement entered into on or after 1/4/2007.

SPECIAL PROVISIONS RELATING TO CERTAIN INCOMES OF NON-RESIDENT INDIAN

Chapter XII-A containing 7 Sections from 115C to 115-I contains special provisions relating to certain incomes of non-resident Indian. All these sections are given below:

DEFINITIONS (115C)

- (a) Convertible Foreign Exchange means foreign exchange which is, for the time being, treated by the Reserve Bank of India as convertible foreign exchange for the purposes of the Foreign Exchange Management Act, 1999 and any Rules made thereunder.
- (b) Foreign Exchange Asset means any specified asset which the assessee has acquired, purchased with or subscribed to, in convertible foreign exchange.
- (c) Investment Income means any income other than dividend referred to in Section 115-O derived from a foreign exchange asset.
- (d) Long-term capital gains means income chargeable under the head "capital gains" relating to a capital asset being a foreign exchange asset which is not a short-term capital asset.
- (e) Non-resident Indian means an individual, being a citizen of India or a person of Indian origin who is not a resident. A person shall be deemed to be of Indian origin if he or either of his parents or any of his grandparents, was born in undivided India.
- (f) Specified Asset means any of the following assets:
 - (i) shares in an Indian company;
 - (ii) debentures issued by an Indian company which is not a private company as defined in the Companies Act, 1956;
 - (iii) deposits with an Indian company which is not a private company;
 - (iv) any security of the Central Government;
 - (v) such other assets as the Central Government may specify in this behalf by notification in the Official Gazette.

COMPUTATION OF INVESTMENT INCOME OF NON-RESIDENT (115D)

No deduction in respect of any expenditure or allowance shall be allowed under any provisions of this Act in computing the investment income of a non-resident Indian -

In case of an assessee being a non-resident Indian -

- (a) if the gross total income consists only of investment income or income by way of long-term capital gains or both, no deductions shall be allowed to the assessee under chapter VI-A (Sections 80C to 80U) and

nothing contained in the provisions of the second proviso to Section 48 shall apply to income chargeable under the head capital gains. (i.e. indexation benefit would not be available)

- (b) if the gross total income of such an assessee includes any income referred to under clause (a) above, the gross total income shall be reduced by the amount of such income and the deductions under chapter VI-A shall be allowed as if the gross total income as so reduced were the gross total income of the assessee.

TAX ON INVESTMENT INCOME AND LONG-TERM CAPITAL GAINS (115E)

Where the total income of an assessee, being a non-resident Indian includes -

- | | |
|---|-----|
| <ul style="list-style-type: none"> (a) Income from foreign exchange asset (not applicable in the case of dividends referred to in section 115-O) | 20% |
| <ul style="list-style-type: none"> (b) Income by way of long term capital gains | 10% |

CAPITAL GAINS ON TRANSFER OF FOREIGN EXCHANGE ASSETS NOT TO BE CHARGED IN CERTAIN CASES (115F)

In a case where a foreign exchange asset is transferred by the assessee and the net consideration for the transfer is invested by him within six months of the date of transfer in any specified asset or in notified savings certificates, any long-term capital gains arising from the transfer will not be charged to tax. If investment in the aforesaid specified assets or savings certificates is less than the net consideration, the exemption from tax in respect of the long-term capital gain will be allowed on proportionate basis.

It is also provided that if the new asset acquired by investing the net consideration realised on transfer of the foreign exchange asset is transferred or converted (otherwise than by transfer) into money, within three years from the date of acquisition, the amount of capital gains earlier exempted will be regarded as capital gains relating to long-term capital asset of the year in which the new asset is transferred or converted (otherwise than by transfer) into money.

'Net Consideration' in relation to the transfer of the original asset means the full value of the consideration received or accruing as a result of the transfer of such assets as reduced by any expenditure incurred wholly and exclusively in connection with such transfer.

RETURN OF INCOME NOT TO BE FILED IN CERTAIN CASES (115G)

A non-resident Indian is not required to furnish his return of income u/s 139(1) if the following conditions are satisfied:

His total income in respect of which he is assessable under this Act during the previous year consists only of investment income or income by way of long-term capital gains or both and the tax at source has been deducted under the provisions of Chapter XVII-B.

BENEFIT UNDER THIS CHAPTER TO BE AVAILABLE IN CERTAIN CASES EVEN AFTER THE ASSESSEE BECOMES RESIDENT (115H)

Where a person, who is a non-resident Indian in any previous year, becomes assessable as resident in India in respect of the total income of any subsequent year, he may furnish to the Assessing Officer a declaration in writing along with his return of income under section 139 for the assessment year for which he is so assessable, to the effect that the provisions of this Chapter shall continue to apply to him in relation to the investment income derived from any foreign exchange asset and if he does so, the provisions of Chapter XII-A shall continue to apply to him in relation to such income for that assessment year and for every subsequent assessment year until the transfer or conversion (otherwise than by transfer) into money of such assets.

In other words, in the case of a non-resident Indian who becomes resident in India in a subsequent year, the provisions of this Chapter XII-A will continue to apply in relation to the investment income derived from debentures of and deposits with an Indian public limited company and Central Government securities acquired in convertible foreign exchange, and other notified assets until the transfer or conversion (otherwise than by transfer) into money of such asset.

CHAPTER NOT TO APPLY IF THE ASSESSEE SO CHOOSES (115-I)

According to this section, a non-resident Indian will have the option or choice of not being assessed under the above provisions, for any assessment year by furnishing his return of income for that assessment year under Section 139, declaring therein his intention to that effect.

MODIFICATION IN THE PROVISIONS OF COMPUTATION OF CAPITAL GAINS FROM SHARES/ DEBENTURES

The first proviso to Section 48 has been amended by the Finance Act, 1992 with effect from the assessment year 1993-94.

Now, with the amendment all non-residents (instead of NRIs) will be entitled to the protection from fluctuation of rupee value against foreign currency in respect of capital gains on shares in or debentures of Indian Companies. Thus, for all non-residents, capital gains arising from the transfer of capital asset being shares in or debentures of an Indian company shall be computed by converting the cost of acquisition, expenditure incurred wholly and exclusively in connection with such transfer and the full value of the consideration received or accruing as a result of the transfer of the capital asset into the same foreign currency as was initially utilised in the purchase of the shares or debentures and the capital gains so computed in such foreign currency shall be reconverted into Indian currency, so however, that the aforesaid manner of computation of capital gains shall be applicable in respect of capital gains accruing or arising from every reinvestment thereafter, in, and sale of shares in, or debentures of an Indian company.

TAX ON DIVIDENDS, ROYALTY AND TECHNICAL SERVICE FEES (SECTION 115A)

A non-resident (other than a company) and a foreign company will pay tax on its income as under:

- (i) On dividend income other than dividends referred to in Section 115-O - @ 20%
- (ii) Interest received from Government or an Indian concern on money borrowed or debt incurred by Government - @ 20%
- (iii) Interest received from an infrastructure debt fund referred to in Section 10(47) - @ 5%.
- (iv) Interest to in Section 194LC - @ 5%.
- (v) Interest referred to in Section 194LD @ 5%.
- (vi) Income received in respect of units, purchased in foreign currency of a Mutual Fund specified in Section 10(23D) (i.e., a mutual fund set-up by a public sector bank or a public financial institution) or of the Unit Trust of India - @ 20%

No deduction in respect of expenditure or allowance shall be allowed to the assessee under Sections 28 to 44C, and 57 and 80C to 80U.

- (vi) Royalty or fees for technical services(FTS) (other than royalty and FTS covered u/s 44DA) received from the Government or an Indian concern in pursuance of an agreement between non-resident and government or an agreement between non-resident and Indian concern for matters covered in Industrial policy shall be taxable @ 25%
- (vii) On any other income at the rates prescribed under the Finance Act of the relevant year.

No requirement of filing of return of Income in case of Interest Income only:

It shall not be necessary for an assessee referred to in sub-section (1) to furnish under sub-section (1) of section 139 a return of his or its income if –

- (a) his or its total income in respect of which he or it is assessable under this Act during the previous year consisted only of income referred to in points (i) to (v) above; and
- (b) the tax deductible at source under the provisions of Chapter XVII-B has been deducted from such income.

TAX ON INCOME FROM UNITS PURCHASED IN FOREIGN CURRENCY (SECTION 115AB)

Special rates of tax are applicable to certain incomes of Overseas Financial organisation. In short, it will be called 'Off-shore Fund'.

The income tax shall be payable at 10% of the following incomes of the Off-shore Fund:

- (i) income received in respect of units purchased in foreign currency; or
- (ii) income by way of long-term capital gains arising from the transfer of units purchased in foreign currency.

The tax @ 10% shall be levied on gross income from the above sources and no deduction will be allowed under Sections 28 to 44C or Sections 57(i) and (iii) or deductions under Sections 80C to 80U. Further, the assessee shall not be entitled to take the indexed cost of acquisition in lieu of cost of acquisition of a long-term capital asset.

TAX ON INCOME OF FOREIGN INSTITUTIONAL INVESTORS FROM SECURITIES OR CAPITAL GAINS ARISING FROM THEIR TRANSFER (SECTION 115AD)

(a) Where a Foreign Institutional Investor receives income in respect of securities other than income by way of dividends referred to in Section 115-O received in respect of securities other than unit referred to in Section 115AB then its income will be taxable @ 20% and the following deductions shall not be allowed in computing the income from securities:

- (i) Deductions under Sections 28 to 44C;
- (ii) Deductions under Sections 57(i) and 57(iii);
- (iii) Deductions under Sections 80C to 80U.

(b) Where the Foreign Institutional Investor earns capital gains (short-term or long-term) on the transfer of securities [mentioned in (a)], it shall not be entitled to claim deductions under Sections 80C to 80U against such capital gains.

The assessee shall not be eligible to calculate capital gains by converting selling price (in Indian currency) into foreign currency which it had brought to invest in securities.

Further, for computation of long-term capital gains, it shall not be entitled to opt indexed cost of acquisition in lieu of cost of acquisition.:.

Foreign Institutional Investor shall pay income tax on such income at the following rates:

On short-term capital gains covered by section 111A	15%
On short-term capital gains on transfer of securities	30%
On long-term capital gains on transfer of securities	10%

The amount of Income tax calculated on the income by way of interest referred to in section 194LD shall be taxable at the rate of 5%.

TAX ON INCOME FROM BONDS OR GLOBAL DEPOSITORY RECEIPTS PURCHASED IN FOREIGN CURRENCY OR CAPITAL GAINS ARISING FROM THEIR TRANSFER (SECTION 115AC)

The Finance Act, 2001, has substituted new Section 115AC for the existing section, to have effect from 1.4.2002, i.e. for assessment year 2002-03 and subsequent assessment years. This section extends the concessional rate of tax to Global Depository Receipts issued under other notified schemes of the Central Government also.

- (a) Global Depository Receipts issued in accordance with a scheme notified by the Central Government in the official gazette against the initial issue of underlying shares of Indian company and purchased by the non-resident in foreign currency through an approved intermediary;
- (b) Global Depository Receipts issued against shares of a public sector company sold by the Government and purchased by the non-resident in foreign currency through an approved intermediary;
- (c) Global Depository Receipts re-issued against the existing underlying shares of an Indian company in accordance with such scheme as the Central Government may notify in the official gazette, and purchased by the non-resident in foreign currency through an approved intermediary;
- (d) Global Depository Receipts issued against shares of a listed Indian company on the disinvestment of such company of its shareholdings in its listed subsidiary company. In accordance with such scheme as the Central Government may notify in the official gazette, and purchased by the non-resident in foreign currency through an approved intermediary.

Where however, the gross total income of the non-resident includes interest income or dividend other than dividends referred to in Section 115-O income from such bonds/GDRs as mentioned above, as well as other income, the gross total income in such case shall be reduced by the amount of such income (i.e. interest/dividend income) and the deduction under Chapter VI-A (i.e. Sections 80C to 80U) shall be applicable on the gross total income as so reduced.

<i>Income</i>	<i>Tax payable</i>
<p>(a) where the total income consist only interest income/dividend income from such bonds/shares or long term capital gains arising from transfer of such bonds/shares</p> <p>First and second provisions to section 48 shall not apply for computation of long term capital gains arising out of the transfer of such Global Depository Receipts being long term capital assets.</p>	10% of such income
<p>(b) where total income includes income as mentioned in (a) above plus other income</p>	10% of income from (a) plus tax payable at normal rate on the balance income i.e. total income minus income of the type as mentioned in (a).

RETURN OF INCOME

It shall not be necessary for a non-resident to furnish under Section 139(1) a return of his income of:

- (a) his total income in respect of which he is assessable under this Act during the previous year consisted only of interest income/dividend income as mentioned above; and
- (b) the tax deductible at source under the provisions of Chapter XVII-B of the Act has been deducted from such income.

TAX ON INCOME FROM GLOBAL DEPOSITORY RECEIPTS PURCHASED IN FOREIGN CURRENCY OR CAPITAL GAINS ARISING FROM THEIR TRANSFER (SECTION 115ACA)

In this section –

“Global Depository Receipts” means any instrument in the form of a depository receipt or certificate (by whatever name called) created by the Overseas Depository Bank outside India and issued to non-resident investors against the issue of ordinary shares or foreign currency convertible bonds of issuing company.

“Information Technology Service” means any service which results from the use of any information technology software over a system of information technology products for realising value addition.

“Overseas Depository Bank” means a bank authorised by the issuing company to issue global depository receipts against issue of foreign currency convertible bonds or ordinary shares of the issuing company.

This section applies to a resident individual employed in an Indian company which is engaged in information technology software and information technology service.

If the total income of such assessee includes -

- (a) dividend income (other than dividends referred to in Section 115-O) on global depository receipts of an Indian company engaged in information technology services, issued in accordance with a notified employees' stock option scheme and purchased in foreign currency.
- (b) income by way of long term capital gains arising from the transfer of global depository receipts referred above. Income tax shall be the aggregate of:
 - (i) tax @ 10% on dividend income referred to in point (a) above;
 - (ii) tax @ 10% on long term capital gains referred to in point (b) above;
 - (iii) the amount of income tax with which the resident employee would have been chargeable had his total income been reduced by the amounts referred to in point (a) and (b) above

It is further provided that if the gross total income of the resident employee consists of dividend income referred to in point (a) above, no deductions under any other provisions of this Act shall be allowed to him.

Further, if gross total income includes any income referred to in point (a) and (b) above, the gross total income shall be reduced by such incomes and deductions under the provisions of this Act shall be allowed on such reduced gross total income of the assessee. Also First and Second provisos to Section 48 shall not apply for computation of long term capital gains arising out of the transfer of such Global Depository Receipts being long term capital assets.

Examples:

Compute the income tax in the following cases:

- (a) Royalty of ₹ 10 lakh received by a foreign company from an Indian concern in pursuance of an agreement approved by the Central Government in the previous year 2013-14.

As per Section 115A, the rate of tax shall be 25%. Hence tax = ₹10 lakh x 25% = ₹ 2,57,500. No surcharge as total income does not exceed ₹ 1 crore.

- (b) ₹ 10 lakh long-term capital gains received by an overseas financial organisation on transfer of units purchased in foreign currency.

Tax rate is 10% under section 115AB. Hence, tax = ₹10 lakh * 10.3% = ₹ 1,03,000.

A new clause (viiA) has been inserted in Section 47 by the Finance Act, 1992 with effect from 1.6.1992, to provide that the transfer of bonds or shares referred to in Section 115AC(1) shall not be regarded as transfer for the purposes of computation of capital gains tax if such transfer is made outside India by one non-resident to another non-resident.

CERTAIN INCOMES OF NON-RESIDENTS TAXABLE IN INDIA

- Profits of business:** Such business profits of a non-resident as can reasonably be attributed to the operations of the business carried out in India are taxable. Note that where the non-resident is making purchase for exports, he is not required to pay tax on any profits he may earn by exports.
- Income from property in India:** The word property is of wide import for this purpose. It may include both movable and immovable property but it must be something tangible. If furniture or machinery is situated in India and is hired under an agreement by which the hire charges are payable outside India, such income shall be taxed in India.
- Income from any assets or source in India:** The words asset or source are of wide import and may include intangible property also like a debt or other chose-in-action. Any income from such sources would be taxable.
- Income from money brought into India and lent on interest:** If a non-resident assessee brings some money into India for lending purposes, any interest earned thereon will be deemed to accrue and arise in India and will, therefore, be taxed in India.
- Fees for Technical Services and Royalties:** Fees received by a foreign enterprise for technical services rendered to an Indian enterprise are taxable in India if either the services are rendered in India or the fees are received in India.

Royalties arise wholly in the country in which the patent, trade-mark process etc., is actually exploited. Thus, royalty received by a foreign patentee for the use of the patent in India shall be construed to arise in India, though the patent may be registered in a foreign country.

Where a foreign company receives royalties from an Indian concern in pursuance of an agreement made by it with the Indian concern after 31.3.61 or, receives fees for rendering technical services from an Indian concern in pursuance of an agreement made by it with the Indian concern after 29.2.1964 and, where such agreement has, in either case, been approved by the Central Government, such income shall be taxed at a rate of fifty per cent.

DOUBLE TAXATION RELIEF

Double taxation arises where various sovereign countries exercise their power to subject the same person to taxes of a similar character on the same income. This may happen when he is taxed on the basis of his personal status, i.e., his nationality, domicile or residence as well as on the basis of place where the income is earned or received.

To avoid double taxation of the same income in two countries, the Central Government may enter into an agreement with the Government of any Country outside India:

- for the grant of relief in respect of income on which income-tax has been paid both under this Act and Income-tax Act in that country, or
- for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country.

In pursuance of Section 90, agreements for grant of relief on double taxation and agreement for avoidance of double taxation are executed by the Government of India from time to time. Some of the countries with which such agreements are in force are: Canada, Korea, New Zealand, Hungary, Czechoslovakia, Belgium, Sri Lanka, Swiss Federal Council, Sweden, Denmark, Finland, Great Britain, Norway, Japan, The Federal Republic of

Germany, Republic of Austria, Greece, Romania, Republic of Lebanon, United Arab Republic, French Republic, Iran, Libya, Malaysia, Singapore, Tanzania, Zambia, Australia, Bulgaria, Ethiopia, Italy, Kuwait, USA, USSR etc.

PROFITS OF NON-RESIDENTS FROM OCCASIONAL SHIPPING BUSINESS (SECTION 172)

The provisions of Section 172 apply for the purpose of levy and recovery of tax in the case of any ship belonging to or chartered by a non-resident, which carries passengers, live-stock, mail or goods shipped at a port in India.

A sum equal to 7-1/2% of the aggregate of the amounts specified below shall be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession":

- (i) The amount paid or payable (whether in or out of India) to the assessee or to any person on his behalf on account of the carriage of passengers, live-stock, mail or goods shipped at any port in India; and
- (ii) The amount received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, live-stock, mail or goods shipped at any port outside India.

However, if the assessee feels that it is in his interest to pay the tax on the basis of his total income, he may claim before the expiry of the assessment year relevant to the previous year in which the date of departure of the ship from Indian port falls, that an assessment be made of his total income of the previous year and the tax payable on the basis thereof be determined in accordance with the other provisions of this Act. If he so claims, any payment made during that previous year shall be treated as a payment of advance tax and the difference between the sum so paid and the amount of tax found payable by him on such assessment shall be paid by him or refunded to him as the case may be.

Before the departure from any port in India of a tram or ship, the master of the ship shall prepare and furnish to the Assessing Officer a return of the full amount paid or payable on account of the carriage of all passengers, live-stock, mail or goods shipped at that port since the last arrival of the ship thereat. If the Assessing Officer is satisfied that it is not possible to furnish the return required before the departure of the ship from the port and the master of the ship has made satisfactory arrangements for the filing of the return and payment of the tax by any other person on his behalf, the Assessing Officer may, if the return is filed within 30 days of the departure of the ship, deem the filing of the return by the person so authorised by the master.

On receipt of the return, the Assessing Officer shall assess the income and determine the sum payable as tax thereon at the rate in force applicable to the total income of a company which has not made the prescribed arrangements for declaration and payment of dividends within India.

A port clearance shall not be granted to a ship until the Port Authority is satisfied that tax assessable has been duly paid or that satisfactory arrangements have been made for the payment thereof.

In the case of *Union of India v. Gosalia Shipping (P) Ltd.*, The Supreme Court has held that where a non-resident company hires a ship from another non-resident and loads the ship with own goods in India, neither the owner of the ship nor the lessee receives any amount on account of the carriage of the goods. No tax is, therefore, leviable under Section 172(2) [113 ITR 307 (S.C.)].

SPECIAL PROVISION FOR COMPUTING PROFITS AND GAINS OF THE BUSINESS OF OPERATION OF AIRCRAFT IN THE CASE OF NON-RESIDENTS (SECTION 44BBA)

(1) In the case of an assessee, being a non-resident engaged in the business of operation of aircraft, a sum equal to 5 per cent of the aggregate of the amounts specified in Sub-section (2) below shall be deemed to be the profits and gains of such business chargeable to tax under the head 'Profits and gains of business or profession'.

(2) The amount referred to above shall be the following:

- (a) The amount paid or payable (whether in or out of India) to the assessee or to any person on his behalf on account of the carriage of passengers, live-stock, mail or goods from any place in India, and

- (b) the amount received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods from any place outside India.

With a view to simplifying the provisions relating to computation of taxable income of a non-resident, Section 44BBA provides that the income from such business shall be computed at a flat rate of 5% of the amount received or receivable by or on behalf of the taxpayer for carriage of passengers, live-stock, mail or goods from any place in India and the amount received or deemed to be received in India on account of such carriage from any place outside India.

DEDUCTIONS OF HEAD OFFICE EXPENDITURE IN CASE OF NON-RESIDENTS (SECTION 44C)

In case of foreign companies having branches in India, deduction in respect of head office expenditure is allowed in computing their income. Section 44C puts a ceiling on such deduction. Accordingly, in the case of assessee being a non-resident, while computing profits and gains of business, deduction in respect of head office expenditure shall not be allowed in excess of the following:

- (a) an amount equal to 5% of the adjusted total income, or
- (b) an amount equal to the average head office expenditure, or
- (c) head office expenditure attributable to the business or profession of the assessee in India, whichever is the least.

In a case where the adjusted total income of the assessee is a loss, the amount under clause (a) shall be computed @ 5% of the average adjusted total income of the assessee. The term 'head office expenditure' means executive and general administration expenditure incurred by the assessee outside India including expenditure incurred in respect of the following:

- (a) Rent, rates, taxes, repairs or insurance of premises outside India used for the purposes of the business or profession;
- (b) Salary, wages, annuity, pension, fees, bonus, commission, gratuity, perquisites or profits in lieu of or in addition to salary, whether paid or allowed to any employee or other person employed in, or managing the affairs of any office outside India;
- (c) Travelling by any employee or other person employed in or managing the affairs of any office outside India; and
- (d) Such other matters connected with executive and general administration as may be prescribed.

DETERMINATION OF INCOME IN CERTAIN CASES (RULE 10)

In any case in which the Assessing Officer (hereafter referred to as A.O.) is of opinion that actual amount of income accruing or arising to any non-resident person through or from any business connection or through or from any property in India or any asset or source of income in India or money lent at interest and brought into India in cash or kind cannot be definitely ascertained, the amount of such income for the purpose of assessment to income-tax may be calculated as under:

- (i) at such percentage of the turnover so accruing or arising as the A.O. may consider to be reasonable; or
- (ii) on any amount which bears the same proportion to the total profits and gains of the business of such person (profits and gains being computed in accordance with the provisions of the Act), as the receipts so accruing or arising bear to the total receipts of the business; or
- (iii) in such other manner as the A.O. may deem suitable.

A non-resident can be taxed either directly or through his agent. Where there is no duly constituted agent in India, the A.O. may statutorily treat any of the following persons as an agent:

- (i) who is employed by or on behalf of the non-resident; or
- (ii) who has any business connection with the non-resident (he may reside anywhere in the world); or
- (iii) from or through whom the non-resident is in receipt of any income whether directly or indirectly; or
- (iv) who is the trustee of the non-resident; or
- (v) who has acquired by means of a transfer a capital asset in India. Such person (transferee) may be resident or non-resident in India.

However, a broker in India who, in respect of any transactions, does not deal directly with or on behalf of a non-resident principal but deals with or through a non-resident broker shall not be deemed to be statutory agent of non-resident, if:

- (i) the transactions are carried on in the ordinary course of business through the Indian Broker; and
- (ii) the non-resident broker is carrying on such transactions in the ordinary course of his business and not as a principal.

If the A.O. wants to treat a person as the agent of a non-resident, he must serve on that person a notice of his intention of treating him as the agent of non-resident and give him an opportunity of being heard as to his liability. If the deemed agent is not satisfied by the order of the A.O., he may appeal to the Appellate Assistant Commissioner against treating him as the agent of a non-resident.

An agent shall be subject to the same duties, responsibilities and liabilities as if the income were income received by or accruing to or in favour of him beneficially, i.e., submission of return, payment of advance tax, payment of tax on regular assessment, recovery of tax, reassessment, etc. He shall be liable to assessment in his own name and any such assessment shall be deemed to be made upon him in his representative capacity and the tax shall be levied and recovered from him in like manner and to the same extent as it would be leviable upon and recoverable from the person represented by him. However, his liability shall be restricted for the year for which he has been deemed to be an agent of the non-resident, after issuance to him of a notice to that effect by the A.O. If the A.O. wants to treat him as an agent of the non-resident for the following year also, a fresh notice for the purpose must be served upon him. Whenever he has been appointed an agent before the end of the previous year, he shall be liable for the payment of tax in advance.

RIGHTS OF AN AGENT

- (i) Where an agent pays any sum under this Act on behalf of a non-resident, he shall be entitled to recover the sum so paid from the person on whose behalf it is paid, or to retain out of any money that may be in his possession or may come to him in his representative capacity, an amount equal to the sum so paid.
- (ii) Any person who apprehends that he may be assessed as an agent may retain out of any money payable by him to the principal, a sum equal to his estimated tax liability. In case of disagreement between the principal and the agent as to the amount to be so retained, the agent may secure from the A.O. a certificate stating the amount to be so retained pending final settlement of the liability. The certificate so obtained shall be his warrant for retaining that amount.

The amount recoverable from the agent at the time of final settlement shall not exceed the amount specified in the certificate, except to the extent to which the agent at such time has in his hands additional assets of the principal. The liability of the statutory agent is personal and not conditional upon his having in hand any funds of the non-resident. If he fails to recover the amount of tax paid by him from the non-resident (on whose behalf it

has been paid), he cannot claim it as a bad debt or as a business loss on ordinary principles of commercial accounting.

INCOMES ESCAPING ASSESSMENT

Where the income of non-resident has escaped assessment, a notice to the statutory agent of the non-resident for assessment or reassessment cannot be issued after expiry of a period of two years from the end of the relevant assessment year.

RECOVERY OF TAX

The tax on the income of a non-resident may be recovered as follows:

- (i) Deduction of tax at source: The amount of tax should be deducted at the prescribed rates by the person who makes the payment to a non-resident.
- (ii) From his Agent or Assets: All property in India belonging to the non-resident principal can be proceeded against for the recovery of tax, on the basis of the assessment made against his statutory agent.
- (iii) Where any property of the non-resident principal is vested in the representative assessee or is under the control or management of the representative assessee, the same may be proceeded against, whether the demand is raised against the representative assessee or against, the beneficiary direct.
- (iv) If there is no property in India of the non-resident at the time of making an assessment, the Assessing Officer may wait till any property of the non-resident comes into India.

The ordinary period of limitation applicable to the commencement of proceedings to recover tax is one year from the end of the financial year in which the demand is made. However, arrears of tax assessed on a statutory agent in respect of income deemed to accrue or arise in India may be recovered from any assets of the non-resident which are, or may, at any time come within India. Consequently, such tax may be realised irrespective of any limitation by way of time.

LESSON ROUND UP

- The foreign investors may be Indian Nationals who reside outside India and other foreign investors including corporations. A person who resides outside India is technically known as “non-resident”. The residential status of an individual does not depend upon the nationality or domicile of that person but it depends upon his stay in India during the previous year.
- A non-resident is not liable to pay tax on his foreign income until and unless it is received in India. Further, remittances to India in any previous year out of earlier year's income, i.e. Income received and/or earned abroad in earlier years, are not charged to Indian Income-tax.
- The Act has provided a large number of concessions to foreigners on their income earned in India.
- Chapter XII-A containing 7 Sections from 115C to 115-I contains special provisions relating to certain incomes of non-resident Indian.
- A non-resident Indian is not required to furnish his return of income u/s 139(1) if his total income in respect of which he is assessable under this Act during the previous year consists only of investment income and the tax at source has been deducted under the provisions of Chapter XVII-B.
- Double taxation arises where various sovereign countries exercise their power to subject the same person to taxes of a similar character on the same income.
- In case of foreign companies having branches in India, deduction in respect of head office expenditure is allowed in computing their income. Section 44C puts a ceiling on such deduction.

- A non-resident can be taxed either directly or through his agent. Where there is no duly constituted agent in India, the A.O. may statutorily treat any of the following persons as an agent:
 - (i) who is employed by or on behalf of the non-resident; or
 - (ii) who has any business connection with the non-resident (he may reside anywhere in the world); or
 - (iii) from or through whom the non-resident is in receipt of any income whether directly or indirectly; or
 - (iv) who is the trustee of the non-resident; or
 - (v) who has acquired by means of a transfer a capital asset in India. Such person (transferee) may be resident or non-resident in India.

SELF TEST QUESTIONS

These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation.

MULTIPLE CHOICE QUESTIONS

1. For which of the following incomes of the Off-shore Fund, the income tax shall be payable at the rate of 10%?
 - (a) Income received in respect of units purchased in foreign currency
 - (b) Income by way of long-term capital gains arising from the transfer of units purchased in foreign currency
 - (c) Both (a) and (b)
 - (d) Neither (a) nor (b)
2. Which of the following incomes of non-residents are taxable in India?
 - (a) Fees for technical services and royalties
 - (b) Income from property in India
 - (c) Profits earned by exports
 - (d) Income from money brought into India and lent on interest
3. For which of the following incomes of the Off-shore Fund, the income tax shall be payable at the rate of 10%?
 - (a) Income received in respect of units purchased in foreign currency
 - (b) Income by way of long-term capital gains arising from the transfer of units purchased in foreign currency
 - (c) Both (a) and (b)
 - (d) Neither (a) nor (b)
4. State with reasons in brief, whether the following statements are correct or incorrect:
 - (a) A non-resident is not liable to pay income-tax on the income earned and received outside India.
 - (b) As per Section 115A of the Income-tax Act, 1961 where the total income of a foreign company includes any dividend, income tax payable on such dividend will be at the rate of 30%.

ELABORATIVE

1. Discuss the provisions regarding tax on income from bonds or global depository receipts purchased in

foreign currency or capital gains arising from their transfer u/s 115AC of the Income Tax Act, 1961.

2. Explain the exemptions and concessions available to non-resident assessee.
3. Under what circumstances can a person be treated as the agent of a non-resident?
4. Mr. A fails to deduct income-tax at source of a sum of ₹ 35,000 paid to Mr. B of U.S.A. who is a non-resident in India. The amount is paid to him as interest on loan taken for the purposes of business. How would you deal with this item as an Assessing Officer?
5. What are the rights of a statutory agent of a non-resident?

PRACTICAL QUESTIONS

1. Cliston, a foreign national, furnishes the following data for the previous year ended 31st March 2014:
 - (a) Royalty from Indian concern under an agreement made on 15th September, 1997 approved by the Central Government ₹ 3,00,000.
 - (b) Expenditure as per section 28 to 44C for earning such income ₹ 2,00,000.
 - (c) Interest from an Indian company on money lent in foreign currency ₹ 11,00,000.
 - (d) Expenditure on collection of above interest ₹ 90,000.
 - (e) Gross sale of business in India ₹ 30,00,000.
 - (f) Expenditure as per section 28 to 44C for above business ₹ 28,00,000.
 - (g) Donation to Prime Minister National Relief Fund ₹ 6,00,000.

Determine the total income of Cliston for the assessment year 2014-15.

2. For the assessment year 2014-15, Harish is a non-resident in India. From the information given below, find out his income chargeable to tax for the assessment year 2014-15:
 - (a) Royalty received by him outside India from the Government of India: ₹17,000.
 - (b) Technical fees received from an Indian company in Germany for advice given by him in respect of a project situated in Iran: ₹ 1,17,000.
 - (c) Income from a business situated in Sri Lanka (goods are sold in Sri Lanka, sales consideration is received in Sri Lanka but business is partly controlled in Sri Lanka and partly in India) ₹ 2,17,000.
 - (d) Income received in Nepal from a business connection in India: ₹ 3,17,000.
 - (e) Gifts in foreign currency from a friend received in India on 20th January, 2014: ₹ 80,000.
 - (f) Past untaxed profit 2001-02 brought in India on 10th April 2013: ₹ 27,000.

ANSWERS/HINTS

Multiple Choice Questions

1. (c); 2. (a), (b) and (d); 3. (c);

Practical Questions

1. ₹ 11,00,000; 2. ₹ 4,14000

SUGGESTED READINGS

- | | |
|--------------------------------|---|
| 1. Dr. V.K. Singhania | : Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi. |
| 2. Girish Ahuja and Ravi Gupta | : Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi. |

Professional Approach to Direct Taxes Law & Practice; Bharat Law House, New Delhi.

3. Dr. V.K. Singhania & Dr. Kapil Singhania : Direct Taxes Law & Practice; Taxmann Publications Pvt. Ltd., New Delhi.

Lesson 10

Collection and Recovery of Tax

LESSON OUTLINE

- Collection and Recovery of Tax
- Payment of Income-Tax
 - (a) Deduction of Tax at Source
 - Consequence in the event of default (Section 201) e-TDS Return :
 - (b) Advance Payment of Tax
- Due Dates and Installments of Advance Tax
- Refunds (Sections 237 to 245)
- Whom to apply for refund?
- For failure to deduct and pay tax at source [Section 201]
- Interest for belated payment of Income-tax [Section 220(2)]
- Interest for default in furnishing Return of Income(Section 234A)
- Interest for default in payment of Advance Tax (Section 234B)
- Interest for deferment of Advance Tax (Section 234C)
- Interest Receivable by the Assessee
- Section 244A (Interest on refunds)
- Lesson Round Up
- Self Test Questions

LEARNING OBJECTIVES

The Income-tax Act provides for collection and recovery of income-tax in the following ways, namely,

- (i) deduction of tax at source in respect of income by way of salaries, interest on securities, interest other than interest on securities, winnings from lotteries and crossword puzzles, winnings from horse-race, insurance commission, dividends, payment to contractors or subcontractors and payments to non- residents;
- (ii) advance payment of income-tax before the assessment by the assessee himself;
- (iii) direct payment of income-tax by the assessee on self-assessment; and
- (iv) payment made after the assessment is made by the Assessing Officer.

Once the tax is being collected either by others, it is their duty to deposit the same to the credit of the Central Government under prescribed procedures stated under the Income Tax Act, 1961. Here the question of TDS arises and in this chapter this aspects of the Income Tax Act has been elaborately discussed with special emphasis on e-TDS and other relevant issues.

At the end of this lesson, you will learn;

- What is tax deducted at source and tax collected at source
- What are the rates of TDS and TCS
- The due dates for payment of TDS and TCS and Advance Tax

The Tax on income is collected in four ways- Tax Deduction at source (TDS), Advance Tax, direct payment of income-tax by the assessee on self-assessment basis and payment after the assessment is made by the Assessing Officer.

COLLECTION AND RECOVERY OF TAX

(a) Notice of Demand (Section 156) (Rules 15, 38, Forms 7, 28)

When any tax, interest penalty, fine or any other sum is payable in consequence of any order passed under this Act, the Assessing Officer shall serve upon the assessee a notice of demand in the prescribed form specifying the sum so payable.

(b) Intimation of loss (Section 157)

When in the course of the assessment of the total income of any assessee, it is established that a loss has taken place which the assessee is entitled to have carried forward and set off against the income in subsequent years, the Assessing Officer shall notify to the assessee by an order in writing the amount of the loss as computed by him for the purposes of carry forward and set off.

(c) Assessee in Default

The amount specified in the notice of demand shall be paid within 30 days of the service of the notice at the place and to the person mentioned in the notice. If the Assessing Officer has any reason to believe that it will be detrimental to revenue if the full period of 30 days is allowed he may, with the prior approval of the Joint Commissioner reduce the period as he thinks fit (Section 220).

If the amount specified in the notice of demand is not paid within the period mentioned in the notice, the assessee shall be liable to pay simple interest at one and one-fourth per cent for every month or part of a month comprised in the period commencing from the day immediately following the end of the 30 days or shorter period, as allowed, and ending with the date of payment of the tax. If the assessee is not in a position to pay the amount in the prescribed time, he may submit an application to the Assessing Officer before the expiry of the due date of the payment. On receipt of such application, the Assessing Officer may extend the time for payment or allow payment by instalments, subject to such conditions as he may think fit to impose. If the amount is not paid as mentioned above, the assessee shall be deemed to be in default and shall be liable to pay in addition to the amount of the arrears and the amount of interest, by way of penalty such amount as the Assessing Officer may direct. In the case of continuing default, he shall be liable to pay such further amount as the Assessing Officer may, from time to time, direct. However, the total amount of penalty shall not exceed the amount of tax in arrears.

Where an assessee is in default or is deemed to be in default in making a payment of tax, the Tax Recovery Officer may draw up under his signature a statement in the prescribed form specifying the amount of arrears due from the assessee and shall proceed to recover from such assessee the amount specified in the certificate (being the statement referred to above) by one or more of the modes mentioned below, in accordance with the rules laid down in the Second Schedule.

- (A)(i) attachment and sale of the assessee's movable or immovable property;
 - (ii) arrest of the assessee and his detention in prison; and
 - (iii) appointing a receiver for the management of the assessee's movable and immovable properties (Section 222).
- (B) The Assessing Officer may also recover the tax by any one or more of the following modes of recovery:
- (i) attachment of salary;
 - (ii) garnishee order;

- (iii) from a court;
- (iv) sale of movable property (Section 226);
- (C) Through State Government (Section 227);
- (D) In pursuance of agreement with foreign countries (Section 228A);
- (E) By suit or under other law (Section 232).

Note: For details please refer to the relevant sections of the Act.

PAYMENT OF INCOME-TAX

The Income-tax Act provides for collection and recovery of income-tax in the following ways, namely,

- (i) deduction of tax at source in respect of income by way of salaries, interest on securities, interest other than interest on securities, winnings from lotteries and crossword puzzles, winnings from horse-race, insurance commission, dividends, payment to contractors or subcontractors and payments to non-residents;
- (ii) advance payment of income-tax before the assessment by the assessee himself;
- (iii) direct payment of income-tax by the assessee on self-assessment; and
- (iv) after the assessment is made by the Assessing Officer.

The provisions relating to tax deduction at source and payment of tax in advance of assessment are being discussed below:

(a) Deduction of Tax at Source

Sections 192 to 206 of the Income-tax Act lay down the provisions relating to deduction of tax at source. The provisions in respect of different incomes are as follows:

(1) Salary (Section 192)

- (i) Any person responsible for paying any income (employer) chargeable under the head "Salaries" shall, at the time of payment, deduct income-tax on the amount payable at the rates applicable to the estimated income of the assessee (employee) under this head for that financial year. It is not the total income that is subject to deduction of tax at source but the estimated income under the head "Salaries" that is important. W.e.f. August 1, 1998, an assessee having an income under the head 'salaries' may furnish in the prescribed manner giving the details of the losses under the head 'Income from House Property' to the person responsible for making the payment who shall take into account such loss for the purposes of computing the tax deductible from salaries, which may be reduced in such a case.

Only where the loss under the head "Income from House Property" has been taken into account TDS deductible from the head salaries may be reduced due to such loss taken into account. For this purpose the salary shall be computed in the same manner as discussed under the head 'Salaries'. From such salary the following deductions shall be made:

- (a) amount deductible Sections 80C, 80D, 80DD and 80DDB.
- (b) deduction under Section 80G, in respect of donations made to the National Defence Fund, Jawahar Lal Nehru Memorial Fund, the Prime Minister's Drought Relief Fund etc. subject to conditions laid down under Section 80G;
- (c) deduction under Section 80GG in respect of rent paid;
- (d) deduction under Section 80RRA in respect of remuneration received in foreign currency;

- (e) deduction under Section 80U on production of a certificate by the employee from the Assessing Officer authorising such deduction. Certificate need not be produced by individuals who have already produced a certificate under the old provision applicable upto 1991-92 assessment year.
- (ii) The employer may, at the time of making any deduction, increase or reduce the amount to be deducted for the purpose of adjusting any excess or deficiency arising out of any previous deductions or failure to deduct during the financial year.
- (iii) The trustees of a recognised provident fund or an approved superannuation fund shall deduct the tax at the time of the accumulated balance due to an employee is paid provided it is not exempted.

No tax will be required to be deducted at source in case the Gross Total income does not exceeds

- ₹ 2,00,000 in case of individual below 60 years of age.
- ₹ 2,50,000 in case of individual having the age of 60 years but below 80 years
- ₹ 5,00,000 in case of individual having the age of 80 years and above.

Where the salary is payable to an assessee outside India in foreign currency its value in rupees shall be the telegraphic transfer buying rate of such currency as on the date on which the tax is required to be deducted at source. 'Telegraphic transfer buying rate' means the rate of exchange adopted by the State Bank of India for buying such currency as made available to the bank through a telegraphic transfer.

Every employer shall file a quarterly return in Form No. 24Q within 15 days from end of quarter and for the quarter ending on 31st March will be submitted on 31st May following the close of the relevant financial year showing:

- (a) the name and address of every employee who is drawing such amount as may be prescribed;
- (b) the amount of income so received by or so due to each such person; and
- (c) the amount of tax deducted and deposited from the income of such person.

The employer shall issue a certificate of deduction of tax to the employee in Form No. 16.

Also, a person responsible for paying any income chargeable under the head "Salaries" is required to furnish, to the person to whom such payment is made, a statement giving correct and complete particulars of perquisites or profits in lieu of salary provided to him and the value thereof in such form and manner as may be prescribed.

(2) Interest on Securities (Section 193)

The person responsible for paying to a resident any income by way of interest on securities shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier deduct income-tax at the rates in force on the amount of the interest payable.

Credit of any income by way of interest on securities to any account, whether called "Interest payable account" or "Suspense account" or by any other name in the books of account of the person liable to pay such income, is, for the purposes of Section 193, deemed to be credit of such income to the payee and attracts applicability of the provisions of Section 193.

However, tax shall not be deducted from the interest on the following securities:

- (i) 4-1/4% National Defence Bonds, 1972 held by a resident individual.
- (ii) 4-1/4% National Defence Loan, 1968 and 4-3/4% National Defence Loan, 1972 and National Development Bonds.

- (iii) 7 year National Savings Certificates IV Issue.
- (iv) Debentures issued by Co-operative Society (including Co-operative Land Mortgage Banks or Co-operative Land Development Banks) or any other institution or authority as the Central Government may specify in the Official Gazette.
- (v) Gold bonds provided the assessee is a resident individual and the nominal value of the bonds did not exceed ₹ 10,000 at any time during the period to which the interest relates.
- (vi) Securities of the Central Government or State Government.
- (vii) Any interest payable to an individual or a Hindu undivided family, who is resident in India, on any debenture issued by a company in which the public are substantially interested, if
 - (a) the amount of interest or, as the case may be, the aggregate amount of such interest paid or likely to be paid on such debenture during the financial year by the company to such individual or Hindu undivided family does not exceed five thousand rupees; and
 - (b) such interest is paid by the company by an account payee cheque.
- (viii) Interest on such debentures as are issued by a statutory corporation or a Government company.
- (ix) Interest payable to the Life Insurance Corporation of India established under the Life Insurance Corporation Act, in respect of any securities owned by it or in which it has full beneficial interest; or
- (x) any interest payable to the General Insurance Corporation of India (hereafter in this clause referred to as the Corporation) or to any of the four companies (hereafter in this clause referred to as such company), formed by virtue of the schemes framed under Sub-section (1) of Section 16 of the General Insurance Business (Nationalization) Act, 1972 (57 of 1972), in respect of any securities owned by the Corporation or such company or in which the Corporation or such company has full beneficial interest; or
- (xi) any interest payable on any other insurer in respect of any securities owned by it or in which it has full beneficial interest."

TDS can be made at the time of payment or at the time of credit to the account of the payee or transfer to interest payable amount or suspense account, whichever comes earlier. The identity of the person in whose hand it is includable have to be identified. Case law: [IDBI v. ITO (2006) 10 SOT 497/104 TTD 230 (Mum.)].

Rate of TDS:

The rate of TDS on Interest on securities is 10%. No education cess and SHEC shall be added to the rate. The rate of TDS shall be 20% if PAN is not quoted by the payee.

(3) Dividends (Section 194)

The principal officer of an Indian company or a company which has made prescribed arrangements for the declaration and payments of dividends within India shall deduct, from the amount of dividend [Dividend under Section 2(22)(a) to (d) payable on or after 1.6.2002] or deemed dividend under Section 2(22)(e), before making any payment in cash or before issuing cheque, income-tax at the prescribed rates.

No such deduction shall be made in the case of shareholder (being an individual, who is resident in India), of a company in which the public are substantially interested, if:

- (a) the dividend is paid by such company by an account payee cheque; and
- (b) the amount of such dividend or, as the case may be, the aggregate of the amounts of such dividend distributed or paid or likely to be distributed or paid during the financial year by the company to the shareholder does not exceed rupees two thousand five hundred.

No such deduction shall be made in respect of any dividends referred to in Section 115-O except where the dividend is covered under section 2(22)(e).

The provisions of Section 194 were amended by the Finance (No. 2) Act 1991 with effect from 1.10.1991 to provide specifically that no TDS shall be deducted on the distribution or payment of dividends to the shareholders who are resident in India.

(4) Interest other than Interest on Securities (Section 194A)

Any person not being an individual or a H.U.F. who is responsible for paying to a resident any income by way of interest other than income by way of interest on securities amounting to more than rupees 5,000 or ₹10,000 as the case may be, shall, at the time of crediting to the payee or at the time of payment or the interest, deduct tax at the prescribed rates.

Rate of Tax:

- (i) 10% plus education cess. No surcharge, education cess or SHEC shall be added from 1st October, 2009.
- (ii) When the payee does not furnish his PAN to deductor, tax will be deducted with effect from 1st April 2010 @ 20%.

However, the tax shall not be deducted in the following cases:

- (i) Where the payee is a banking Company, a co-operative society engaged in carrying on the business of banking or any deposit with post office under any scheme framed by the Central Government and notified by it in this behalf, and the aggregate amount of interest credited or paid during the financial year does not exceed ₹ 10,000.
- (ii) Where the payee is other than the (i) above and the aggregate amount of interest paid or credited does not exceed ₹5,000.
- (iii) Where the interest credited or paid to a banking company, a co-operative society doing banking business, Financial Corporation established by a Central or State Act, the Life Insurance Corporation of India, the Unit Trust of India, any company or co-operative society carrying on the insurance business and any other institution which the Central Government may notify in this behalf.
- (iv) Interest credited or paid by a firm to its partners.
- (v) Interest credited or paid by a co-operative society to its members or to any other co-operative society.
- (vi) Where interest credited or paid in respect of deposits under any scheme framed by Central Government.
- (vii) Interest credited or paid in respect of deposits other than time deposits with a banking company to which the Banking Regulation Act, 1949 applies.
- (viii) income credited or paid in respect of deposits with a primary agricultural credit society or cooperative society engaged in carrying on the business of banking including a cooperative land mortgage bank or a cooperative land development bank.
- (ix) income credited or paid by the Central Government under Income Tax Act, 1961 or Indian Income Tax Act, 1922 or the Estate Duty Act, 1953 or the Wealth Tax Act, 1957 or the Gift Tax Act or the Super Profits Tax Act, 1963 or the Companies (Profits) Surtax Tax Act, 1964 or the Interest Tax Act, 1974.
- (x) income which is paid or payable by an infrastructure capital company or infrastructure capital fund or a public sector company in relation to a zero coupon bond issued on or after the 1st day of June 2005 by such company or fund or public sector company.

- (xi) to such income credited or paid by way of interest on the compensation amount awarded by the Motor Accidents Claims Tribunal where the amount of such income or, as the case may be, the aggregate of the amounts of such income credited or paid during the financial year does not exceed fifty thousand rupees.

The responsible person may, at the time of making any deduction increase or reduce the amount to be deducted for the purpose of adjusting any excess or deficiency arising out of any previous deductions or failure to deduct during the financial year.

The responsible person shall file a shall file quarterly return in Form No. 26Q with in 15 days from end of quarter and for the quarter ending on 31st March will be submitted by 15th May following the close of the financial year showing the names and addresses of the person and the amount paid or credited to each of such person.

With effect from 1.6.2002, individuals and HUF covered under Section 44AB(a) and (b) i.e. whose gross turnover of the business in the immediately preceding financial year exceeds ₹ 1 crore (or receipts from the profession ₹ 25 Lakh), are also required to deduct tax at source.

Cheque discounted charges are different from interest payments and provisions of Section 194A are not attracted. ITO v. A.S. Babu Sah (2003) 86 ITD 283 (Mad.)

(5) Winnings from Lotteries or Crossword Puzzles (Section 194B)

The person responsible for paying to any person any income by way of winnings from lotteries or crossword puzzles or card game and other game of any sort, an amount exceeding ₹10,000 shall deduct tax at the prescribed rates at the time of such payment and a statement in Form No. 26 has to be filed by the end of the month of June falling in the financial year immediately following the previous year. No such deduction shall be made from any such payment before 1.6.1972.

Rate of Tax:

The prescribed rate is 30%. No surcharge, education cess or SHEC shall be added from 1st October 2009. When the payee does not furnish his PAN to deductor, tax will be deducted with effect from 1st April 2010 @ 20%.

Important Points

- (i) When the prize is given partly in cash and partly in kind, income-tax will be deducted from cash prize with reference to the aggregate amount of the cash prize and the value of the prize in kind.
- (ii) No income-tax will be deducted from the prize given only in kind.
- (iii) When the prize is given in instalments, the tax will be deducted only at the time of actual payment of each instalment.
- (iv) Income-tax is not deductible from the income by way of bonus or commission paid to lottery agent or sellers of lottery tickets on the sales made by them.

Prizes won by lottery agent under "Lucky dip draws" are lotteries for the purposes of deduction of tax at source (Circular dated 11-2-1980).

(6) Winnings from Horse Races (Section 194BB)

Income-tax has to be deducted at source from any income by way of winnings from horse races at such rate as may be prescribed by the annual Finance Act. Deduction of tax at source will be made only in cases where the income by way of winnings from horse races to be paid to a person exceeds ₹5,000. The obligation to deduct tax at source will apply only where such winnings are paid by a book maker or a person to whom a licence has been granted by the Government under any law for the time being in force for horse racing in any race course or for arranging for wagering or betting in any race course.

Rate of Tax:

The prescribed rate is 30%. No surcharge, education cess or SHEC shall be added from 1st October 2009. When the payee does not furnish his PAN to deductor, tax will be deducted with effect from 1st April 2010 @ 30%.

(7) Payment to Resident Contractor or Sub-contractor (Section 194C)

Any person responsible for paying to any of the contractor for carrying out any work (including supply of labour for carrying out any work) in pursuance of a contract shall, at the time of credit of such sum to the account of the contractor or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier.

Rate of Tax:

- (i) 1% where the payment is being made or credit is being given to an individual or a Hindu undivided family;
- (ii) 2% where the payment is being made or credit is being given to a person other than an individual or a Hindu undivided family, of such sum as income-tax on income comprised therein.
 - No surcharge, education cess or SHEC shall be added from 1st October, 2009.
 - When the payee does not furnish his PAN to deductor, tax will be deducted with effect from 1st April 2010 @ 20%.

No individual or Hindu undivided family shall be liable to deduct income-tax on the sum credited or paid to the contractor

No deduction shall be made from the amount of any sum credited or paid to, the contractor, if such sum does not exceed ₹ 30,000

Provided that where the aggregate of the amounts credited or paid during the financial year exceeds ₹75,000 the person responsible for paying shall be liable to deduct income-tax.

No deduction shall be made from any sum paid or credited during the previous year to the account of a contractor during the course of business of plying, hiring or leasing goods carriages, on furnishing of his Permanent Account Number, to the person paying or crediting such sum.

Explanation. – For the purposes of this section, –

- (i) Any person, being an individual or a Hindu undivided family or an association of persons or a body of individuals, if such person, –
 - (A) does not cover above and
 - (B) is liable to audit of accounts under clause (a) or clause (b) of section 44AB during the financial year immediately preceding the financial year in which such sum is credited or paid to the account of the contractor;

shall be liable to deduct income tax from such sum paid or credited.

- (ii) “contract” shall include sub-contract;
- (iii) “work” shall include –
 - (a) advertising;
 - (b) broadcasting and telecasting including production of programmes for such broadcasting or telecasting;

- (c) carriage of goods or passengers by any mode of transport other than by railways;
- (d) catering;
- (e) manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer, but does not include manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from a person, other than such customer.

(8) Insurance Commission (Section 194D)

Any person responsible for paying to a resident any income by way of commission or otherwise for soliciting or procuring insurance business (including continuance or renewal of policies) shall, at the time of crediting the account of the payee or at the time of payment thereof, whichever is earlier. No deduction shall be made from the amount of any sum credited or paid to, if such sum does not exceed ₹20,000.

Rate of Tax:

The prescribed rate is 10%. No surcharge, education cess or SHEC shall be added from 1st October 2009. When the payee does not furnish his PAN to deductor, tax will be deducted with effect from 1st April 2010 @ 20%.

(9) Payment in respect of Deposits under National Savings Scheme etc. (Section 194EE)

The person responsible for paying to any person any amount referred to in Section 80CCA(2)(a) shall, at the time of payment thereof, deduct income-tax at the rate of 20%. No deduction shall, however, be made under Section 194EE where the amount of such payment or the aggregate of such payment to the payee during the financial year is less than ₹ 2,500. Further, nothing contained in Section 194EE shall apply to the payment of the said amount to the heirs of the assessee.

Rate of Tax:

The prescribed rate is 20%. No surcharge, education cess or SHEC shall be added from 1st October 2009. When the payee does not furnish his PAN to deductor, tax will be deducted with effect from 1st April 2010 @ 20%.

(10) Commission, etc. on sale of lottery tickets (Section 194G)

Any person paying any income by way of commission, remuneration or prize (by whatever name called) on lottery tickets on amounts exceeding ₹ 1,000 shall deduct income-tax at the rate of 10%. No surcharge, education cess or SHEC shall be added from 1st October 2009. When the payee does not furnish his PAN to deductor, tax will be deducted with effect from 1st April 2010 @ 20%. irrespective of the fact whether the payment is made in cash or by the issue of a cheque or draft or by any other mode. The provisions of Section 194G have been extended to any account, whether called 'suspense account' or by any other name in the books of account of the person liable to pay.

(11) Commission or Brokerage (Section 194H)

Any person, not being an individual or a Hindu Undivided Family, who is responsible for paying, or after 1st day of June, 2001, to a resident any income by way of commission (not being insurance commission referred to in Section 194D) or brokerage, shall, at the time of credit of such income to the account of the payee or at the time of payment of such income in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rate of 10%. No surcharge, education cess or SHEC shall be added from 1st October 2009. When the payee does not furnish his PAN to deductor, tax will be deducted with effect from 1st April 2010 @ 20%..

Provided that no deductions shall be made under this section in a case where the amount of such income or, as the case may be, the aggregate of the amounts of such income credited or paid or likely to be credited or paid during the financial year to the account of, or to, the payee, does not exceed ₹ 5,000

Individuals and HUF covered under Section 44AB(a) and (b) i.e. whose gross turnover of the business in the immediately preceding financial year exceeds ₹ 1 crore (or receipts from the profession ₹ 25,00,000), are also required to deduct tax at source.

(12) Rent (Section 194-I)

A new Section 194-I in the Income-tax Act relating to deduction of Income-tax at source has been inserted by the Finance Act, 1994.

Any person other than an individual or a HUF who is responsible for paying to a resident any income by way of rent is required to deduct tax from rent if such rent is in excess of ₹ 1,80,000 per financial year. Tax is to be deducted @ 2% for use of any machinery or plant or equipment; and @ 10% for the use of any land or building (including factory building) or furniture or fittings. No surcharge, education cess or SHEC shall be added from 1st October 2009. When the payee does not furnish his PAN to deductor, tax will be deducted with effect from 1st April 2010 @ 20%.

Explanation: For the purpose of this section:

- (i) "rent" means any payment, by whatever name called, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of any land or any building (including factory building), together with furniture, fittings and the land appurtenant thereto, whether or not such building is owned by the payee.
- (ii) where any income is credited to any account, whether called "suspense account" or by other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and the provisions of this section shall apply accordingly.

Individuals and HUF covered under Section 44AB(a) and (b) i.e. whose gross turnover of the business in the immediately preceding financial year exceeds ₹ 1 crore (or receipts from the profession ₹ 25,00,000), are also required to deduct tax at source.

Payment made to C&F agent are regarded as payment made for carrying out work under Section 194C instead of treating it as rent – *National Panasonic India (P) Ltd. v. CIT (TDS)* (2005) 35 OT 16 Del. Payment for advertisement for boarding site is dealt under Section 194C. - *ITO v. Roshan Publicity (P) Ltd.* (2005) 45 OT 105 Mum. Landing and Parking Fee received by Airport Authorities is treated as rent as was decided in the case *United Airlines v. CIT* (2006) 152 Taxman 516 Del.

(13) Payment on transfer of certain immovable property other than agricultural land (Section 194-IA)

Any person, being a transferee, responsible for paying (other than the person referred to in section 194LA) to a resident transferor any sum by way of consideration for transfer of any immovable property (other than agricultural land), shall, at the time of credit of such sum to the account of the transferor or at the time of payment of such sum in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct an amount equal to one per cent of such sum as income-tax thereon.

No deduction shall be made where the consideration for the transfer of an immovable property is less than 50 lakh rupees.

- (a) "agricultural land" means agricultural land in India, not being a land situate in any area referred to in items (a) and (b) of sub-clause (iii) of clause (14) of section 2;
- (b) "immovable property" means any land (other than agricultural land) or any building or part of a building.

The provisions of section 203A shall not apply to a person required to deduct tax in accordance with the provisions of this section.

Procedure to be followed for Depositing of Tax

This section is applicable on 1st June 2013, there was a confusion regarding the depositing the tax and claim of such tax deposited. Whether the deductor would have to apply for a TAN and how and when the tax is to be deposited.

As per section 194-IA, every person (even individuals) making a payment for consideration of an immovable property, not including agricultural land, will withhold tax @ 1% of the transaction amount.

As per notification no. 39/2013 dated 31 May 2013 the following things have been made clear:

1. *Depositing of withholding tax.*
2. *Issuance of certificates for such tax*
3. *Filing a return of withholding tax.*

The following procedure is followed:

The amount deducted under section 194-IA shall be deposited with the Central Government within 7 days from the end of the month in which the amount was deducted. For example, if amount is deducted on 15th June, then amount shall be paid to the credit of Central Government by 7th July.

TDS payment made u/s 194-IA is to be necessarily accompanied by a challan-cum-statement in Form No.26QB.

The amount shall be deposited electronically within the time specified above with the RBI or the SBI or any other authorized bank.

Deductor is liable to furnish the certificate of the tax deducted at source in Form No. 16B to the deductee within 15 days from the due date of furnishing Form No. 26QB.

TDS deductor shall provide a certificate under Form 16B which is to be generated online from the web portal.

(14) Professional and technical fees (Section 194J)

Any person other than an individual or a HUF is required to deduct tax @ 10% on professional or technical fees or on any remuneration or fees or commission by whatever name called, other than those on which tax is deductible under section 192, to a director of a company; or royalty, or any sum referred to in clause (va) of section 28 at the time of payment or credit whichever is earlier if the aggregate of such fees given to a person is likely to be more than ₹ 30,000 in a previous year. No surcharge, education cess or SHEC shall be added from 1st October 2009. When the payee does not furnish his PAN to deductor, tax will be deducted with effect from 1st April 2010 @ 20%.

(15) Payment of compensation on acquisition of capital asset (Section 194LA)

This section has been inserted by Finance (No. 2) Act, 2004 w.e.f. 1.10.2004. It applies to any person responsible for paying to a resident any sum being in the nature of compensation or enhanced compensation or consideration or enhanced consideration on account of compulsory acquisition of any asset under any law for the time being in force. Such person, at the time of payment of such sum in cash or by issue of a cheque or draft or by any other mode whichever is earlier, shall deduct an amount equal to 10% and no surcharge, education cess or SHEC shall be added from 1st October 2009. When the payee does not furnish his PAN to deductor, tax will be deducted with effect from 1st April 2010 @ 20% of such sum as income tax on income comprised therein. However, no deduction shall be made where the amount of such payment or aggregate of such payments during the financial year does not exceed ₹ 2 lakh.

(16) Income by way of interest from infrastructure debt fund (Section 194LB)

Where any income by way of interest is payable to a non-resident, not being a company, or to a foreign company, by an infrastructure debt fund referred to in clause (47) of section 10, the person responsible for making the payment shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon @5%.

(17) Income by way of interest from Indian company engaged in certain business (Section 194LC)

Where any income by way of interest is payable to a non-resident, not being a company or to a foreign company by a specified company, the person responsible for making the payment, shall at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct the income-tax thereon @5%.

(2) The interest shall be the income by way of interest payable by the specified company,-

- (i) in respect of monies borrowed by it at any time on or after the 1st day of July, 2012 but before the 1st day of July, 2015 in foreign currency, from a source outside India, –
 - (a) under a loan agreement; or
 - (b) by way of issue of long-term infrastructure bonds, as approved by the Central Government in this behalf; and
- (ii) to the extent to which such interest does not exceed the amount of interest calculated at the rate approved by the Central Government in this behalf; having regard to the terms of the loan or the bond and its repayment.
 - (a) "foreign currency" shall have the meaning assigned to it in clause (m) of section 2 of the Foreign Exchange Management Act, 1999(42 of 1999);
 - (b) "specified company" means an Indian company.

(18) Income by way of interest on certain bonds and Government securities (Section 194LD)

Any person who is responsible for paying to a person being a Foreign Institutional Investor or a Qualified Foreign Investor, any income by way of interest shall, at the time of credit of such income to the account of the payee or at the time of payment of such income in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax @5%.

The income by way of interest shall be the interest payable on or after the 1st day of June, 2013 but before the 1st day of June, 2015 in respect of investment made by the payee in –

- (i) a rupee denominated bond of an Indian company ; or
- (ii) a Government security:

However, the rate of interest in respect of bond referred to in clause (i) shall not exceed the rate as may be notified by the Central Government.

- (a) "*Foreign Institutional Investor*" shall have the meaning assigned to it in clause (a) of the *Explanation to section 115AD*;
- (b) "*Government security*" shall have the meaning assigned to it in clause (b) of section 2 of the *Securities Contracts (Regulation) Act, 1956* (42 of 1956);
- (c) "*Qualified Foreign Investor*" shall have the meaning assigned to it in the *Circular, No. Cir/IMD/DF/14/2011, dated the 9th August, 2011, as amended from time to time, issued by the Securities and Exchange Board of India, under section 11 of the Securities and Exchange Board of India Act, 1992* (15 of 1992).

(19) Payments of other sums to Non-residents (Section 195)

Any person responsible for paying to a non-resident or foreign company any interest or any other sum chargeable to income-tax in India, not being salaries, shall at the time of payment, deduct tax at the rates in force.

However, no such deduction shall be made in respect of any dividends referred to in Section 115-O.

In the case of interest payable by the government or a public sector bank or a public financial institution within the meaning of Section 10(23D), deduction of tax shall be made only at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode.

Credit of any amount to 'Suspense Account' or any other account in the books of account of the person liable to pay such income is also deemed to be 'credit' of the income to the account of the payee and makes the provisions of this section applicable to such cases.

If the person responsible for such payments, feels that the whole amount would not be income chargeable in the case of recipient he may make an application to the Assessing Officer to determine the chargeable portion and he shall deduct tax on the sum so determined. Further, the assessee may apply to the Assessing Officer to grant a certificate for either no deduction of tax at source or deduction at a lower rate. If the Assessing Officer is satisfied, he can issue a certificate accordingly and the certificate shall remain in force till the expiry of the period specified therein or its cancellation by the Assessing officer whichever is earlier.

As a result of amendment made by the Finance (No. 2) Act, 1991 with effect from 1.10.1991 in Section 195, reference to the word 'dividend' has been omitted.

Payment made by Indian company to U.S. Company for use of its data base is not subjected to TDS under Section 195 of the Income Tax Act. - WIPRO Ltd. v. I.T.O. (2005) 94 ITD 9 (Bang.).

(20) Other Provisions

Section 196 provides that no deduction of tax shall be made (notwithstanding anything contained in the foregoing provisions of Chapter XVII) by any person from any sums payable to :

- (i) the Government; or
 - (ii) the Reserve Bank of India; or
 - (iii) a corporation established by or under a Central Act which is, under any law for the time being in force, exempt from income-tax on its income; or
 - (iv) a Mutual Fund specified under Section 10(23D);
- where such sum is payable to it by way of interest or dividend in respect of any securities or shares owned by it or in which it has full beneficial interest, or any other income accruing or arising to it.

Where in the case of any income of any person, the Assessing Officer is satisfied that the total income of the person justifies the deduction of income-tax at any lower rate or no deduction of income-tax, he shall, on an application made by the assessee in this behalf, give to him such certificate as may be appropriate. Where such certificate is given, the person responsible for paying the income shall, until such certificate is cancelled by the Assessing Officer, deduct income-tax at the rates specified in the certificate or deduct no tax, as the case may be (Section 197).

With effect from 1st January 2013, no tax shall be deducted on the following payments where such payment is made by a person to a bank listed in the Second Schedule to the Reserve Bank of India Act, 1934, excluding a foreign bank;

- (i) bank guarantee commission;

- (ii) cash management service charges;
- (iii) depository charges on maintenance of DEMAT accounts;
- (iv) charges for warehousing services for commodities;
- (v) underwriting service charges;
- (vi) clearing charges (MICR charges);
- (vii) credit card or debit card commission for transaction between the merchant establishment and acquirer bank.

Section 196A provides that any person responsible for paying to a non-resident, except a company, or to a foreign company, any income in respect of units of a mutual fund specified u/s 10(23D) or of the Unit Trust of India shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in case, whichever is earlier, deduct income tax thereon @ 20%. However, no such deduction shall be made under this section if such income is credited or paid on or after the 1st day of April, 2003.

However, no deduction of tax shall be made from any income payable in respect of units of the Unit Trust of India to a non-resident Indian or a non-resident Hindu undivided family, where the units have been acquired from the Unit Trust of India out of the funds in a Non-resident (External) Account maintained with any bank in India or by remittance of funds in foreign currency, in accordance, in either case, with the provisions of the Foreign Exchange Management Act, 1999 and the rules made thereunder.

(21) Income from units

According to Section 196B the person responsible for making the payment in respect of units referred to in Section 115AB or by way of long-term capital gains arising from the transfer of such units is payable to an offshore fund shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rate of ten percent.

(22) Income from foreign currency bonds or shares of Indian Company

With effect from June 1, 1992, Section 196C has been inserted to provide for a deduction of income-tax at the rate of ten percent from the interest income or dividend income in respect of bonds or shares referred to in Section 115AC or by way of long-term capital gains arising from the transfer of such bond or share capital to a non-resident. However, no such deduction shall be made in respect of any dividends referred to in Section 115-O.

The person responsible for making such payment shall at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode whichever is earlier, deduct the income-tax thereon @ 10%.

(23) Income of Foreign Institutional Investors from securities

According to Section 196D, where any income in respect of securities referred to in clause (a) of Sub-section (1) of Section 115AD is payable to a Foreign Institutional Investor, the person responsible for making the payment shall, at the time of credit of such income to the account of the payee or at the time of payment thereof, whichever is earlier, deduct income-tax at the rate of twenty per cent. However, no such deduction shall be made in respect of any dividends referred to in Section 115-O.

Also no deduction of tax shall be made from any income by way of capital gains arising from the transfer of securities referred to in Section 115AD payable to a Foreign Institutional Investor.

(24) No deduction to be made in certain cases

Section 197A provides that no deduction of tax at source is to be made from (i) interest on securities, (ii) dividends, and (iii) payments in respect of deposits under NSS, etc. if the following conditions are satisfied:

- (i) The recipient of such income is an individual and resident in India.
- (ii) Such person furnishes a declaration in writing in duplicate, in the prescribed form and verified in the prescribed manner, to the payer of such income to the effect that the tax on his estimated total income of the previous year in which such income is to be included for computing his total income will be nil.

Sub-section 197A(1A) has been inserted with effect from June 1, 1992. This sub-section provides that in case of interest other than interest on securities, a declaration referred to above can be furnished by any person (other than a company or a firm).

The payer of the aforesaid income will deliver to Chief Commissioner or Commissioner of Income-tax one copy of the declaration (received from the recipient of income) on or before the 7th day of the month next following the month in which the declaration is furnished. If he fails to do so he will be liable to a penalty of an amount which shall not be less than one hundred rupees but which may extend to two hundred rupees for every day during which the default continues.

(25) Tax deducted is income received (Section 198)

The tax deducted at source is deemed to be the income received, by the assessee for the purpose of computing his income.

(26) Certificate of tax deducted (Section 203)

The person who deducts tax has to issue a certificate in the prescribed form to the person from whose payments deduction has been made, showing therein the particulars of payment, the date of tax deducted at source and the date of its credit to the Central Government. It is on the basis of this certificate that the payee can claim credit for tax paid on his behalf and can claim refund, if any, due to him on the basis of tax liability for the relevant year.

(27) Consequence in the event of default (Section 201)

Where any person, including the principal officer of a company,

- (a) who is required to deduct any sum in accordance with the provisions of this Act; or
- (b) referred to in sub-section (1A) of section 192, being an employer,

does not deduct, or does not pay, or after so deducting fails to pay, the whole or any part of the tax, as required by or under this Act, then, such person, shall, without prejudice to any other consequences which he may incur, be deemed to be an assessee in default in respect of such tax:

However, any person, including the principal officer of a company, who fails to deduct the whole or any part of the tax in accordance with the provisions of this Chapter on the sum paid to a resident or on the sum credited to the account of a resident shall not be deemed to be an assessee in default in respect of such tax if such resident

- (i) has furnished his return of income under section 139;
- (ii) has taken into account such sum for computing income in such return of income; and
- (iii) has paid the tax due on the income declared by him in such return of income,

and the person furnishes a certificate to this effect from an accountant in form 26A.

No penalty shall be charged under section 221 from such person, unless the Assessing Officer is satisfied that such person, without good and sufficient reasons, has failed to deduct and pay such tax.

If a person responsible for deduction of tax at source fails to deduct the appropriate tax or, after making the due deduction fails to deposit it into the Government treasury, he shall be deemed to be an assessee in default and shall be liable to:

- (i) Payment of the whole or any part of the tax as due
 - (ii) Interest at the rate of 1 per cent per month or part of the month on the tax from the date on which such tax was deductible to the date on which such tax is deducted; and
 - (iii) Interest at the rate of 1½ per cent per month or part of the month on the tax from the date on which such tax was deducted to the date on which such tax is actually paid;
- However, in case any person, including the principal officer of a company fails to deduct the whole or any part of the tax on the sum paid to a resident or on the sum credited to the account of a resident but is not deemed to be an assessee in default, the interest shall be payable from the date on which such tax was deductible to the date of furnishing of return of income by such resident.
- (iv) Penalty which may be as high as the amount of the tax in default, however, no penalty shall be charged under Section 221 from such person unless the Assessing Officer is satisfied that such person has, without good and sufficient reasons, failed to deduct and pay the tax; and
 - (v) Prosecution - where the amount of tax which the responsible person has failed to deduct or pay exceeds ₹ 1,00,000 he shall be punishable with rigorous imprisonment for a term not less than 6 months but which may be extended to 7 years and with fine. In any other case, he shall be punished with a rigorous imprisonment of a term of not less than 3 months but which may be extended to 3 years and with fine.

Where the amount of tax has not been deposited after it is deducted, the amount of tax together with the interest shall be a charge upon all the assets of the person.

The following table will give the list of forms of certificates to be issued and necessary form to be filed with Assessing Officer by the persons deducting the tax at source.

<i>Categories of payment</i>	<i>Form No. of Certificate</i>	<i>Form No. of return to be filed with Assessing Officer</i>
(1)	(2)	(3)
(a) Salaries	12BA, 16, 16AA	24Q
(b) Interest on Securities (Government)	16A	26Q
(c) Interest on Securities (others)	16A	26Q
(d) Interest other than Interest on Securities	16A	26Q
(e) Dividends	16A	26Q
(f) Winnings from Lotteries/Crossword puzzles	16A	26Q
(g) Winnings from Horse Races	16A	26Q
(h) Payments to contractors/Sub-contractors	16A	26Q
(i) Insurance commission	16A	26Q
(j) Non-resident sportsmen or sports association	16A	26Q
(k) National Savings Scheme etc.	16A	26Q

(l) Income on repurchase of units by mutual funds or UTI	16A	26Q
(m) Commission, Remuneration or Reward on sale of lottery tickets	16A	26Q
(n) Payment to non-resident	16A	27Q
(o) Foreign company being unit holders of mutual fund	16A	27Q
(p) Units held by offshore fund and income from foreign currency bonds	16A	27Q
(q) Rent	16A	26Q
(r) Commission (not being insurance commission) or brokerage	16A	26Q
(s) Fee for professional or technical services	16A	26Q

E-TDS Return

E-TDS return is prepared in the form Nos. 24Q, 26Q or 27Q in electronic media as per prescribed data structure either in a floppy or in a CD-ROM. The floppy or CD-ROM prepared should be accompanied by Form No. 27A should be signed and verified in the prescribed manner. As per Section 206 of the Income Tax Act Corporate and Government deductors are compulsorily required to file their TDS return through electronic media. However, for other deductors filing of e-TDS return is optional and e-TDS return should be filed under Section 206 of the Income Tax Act in accordance with a scheme dated 26th August, 2003 for electronic filing of TDS return vide CBDT Circular No.8 dated 19.09.2003. The CBDT has appointed the Director General of Income Tax (Systems) as e-filing administrator for the purpose of electronic filing of returns of TDS Scheme, 2003. CBDT has also appointed National Securities Depository Limited (NSDL) as e-TDS intermediary. E-TDS return can be filed at any of the TIN-FC opened by the e-TDS intermediary for this purpose. The due date for filing quarterly TDS return both electronic and conventional form remains the same.

E-Filing of quarterly statement of TDS is mandatory for the deductors where;

- The deductor is an office of the Government
- The deductor is the principal officer of a company
- The deductor is a person required to get his accounts audited under section 44AB in the immediately preceding financial year or
- The number of deductees records in a quarterly statement for any quarter of the financial year are twenty or more,

Other than the above, any other deductor may also opt to furnish the statement electronically.

ADVANCE PAYMENT OF TAX

The computation of advance tax liability, under different situations, is to be done as follows:

Section 207-219 of the Income Tax Act deals with the issues relating to advance payment of tax. In advance payment of tax, the assessee has to pay tax in a financial year under estimated income which is to be taxed in the subsequent assessment year. It follows the doctrine known as pay as you earn scheme.

ADJUSTMENT OF ADVANCE TAX

Under Section 219, the total advance tax paid by an assessee other than for interest be adjusted against the

total tax liability computed under regular assessment.

Under Section 234B of the Act where an assessee, who is liable to pay advance tax, under Section 208 has failed to pay such tax or where the advance tax paid under Section 210 is less than 90% of the assessed tax, he shall be liable to pay interest @ 1% for every month or part of the month.

Assessee has to pay advance tax even in respect of book profit tax under Section 115JB otherwise it is liable for interest under Sections 234B and 234C.

It is kind of mandatory payment of tax, assessed by the assessee himself on income before completion of the Financial Year.

LIABILITY OF THE ASSESSEE

It is obligatory for an assessee to pay advance tax where the advance tax payable is ₹10,000 or more (Section 208).

In order to reduce the compliance burden on senior citizens exemption from payment of advance tax section 207 has been amended to provide that resident individual –

- (1) not having any income chargeable under the head “Profits and gains of business or profession” and
- (2) of age 60 years or more need not pay advance tax and are allowed to discharge their tax liability (other than TDS) by payment of self-assessment tax.

Due Dates for Payment of Advance Tax

<i>Particulars</i>	<i>In case of corporate assessee</i>	<i>In case of non-corporate assessee</i>
On or before June 15 of the Previous year	Upto 15% of the Advance Tax due	—
On or before September 15 of the previous year	Upto 45% of the Advance Tax due as reduced by amount paid in earlier instalments	Upto 30% of the advance tax payable.
On or before December 15 of the previous year	Upto 75% of the Advance Tax due as reduced by amount paid in earlier instalments	Upto 60% of the advance tax payable as reduced by amount paid in earlier instalments
On or before March 15 of the previous year	Upto 100% of the Advance Tax due as reduced by amount paid in earlier instalments	Upto 100% of the advance tax payable as reduced by amount paid in earlier instalments

Any payment of advance tax payable made before March 31 shall be treated as advance tax paid during the financial year.

In case of public holiday or bank holiday, date of payment automatically falls in the next working day and for that delay, interest is not charged under Sections 234B and 234C vide Circular No. 676 dated 14.01.1994.

Tax to be computed at the prevailing rate on the current income of the assessee, in a financial year.

ROLE OF ASSESSING OFFICER IN RELATION TO ADVANCE PAYMENT OF TAX

An Assessing Officer (AO) can order payment of advance tax if following conditions are satisfied:

- (i) The assessee has already been assessed by way of regular assessment in respect of total income of any previous year.;

- (ii) Failure to pay tax by such assessee.
- (iii) The AO is of the opinion that such person is liable to pay advance tax on current year's income.
- (iv) The order must specify the amount of advance tax and instalments in which advance tax has to be paid.
- (v) Such order may be passed during the previous year but not later than last day of February.
- (vi) The order must be made in writing.

The assessee can pay advance tax at a rate lower than assessment made by the AO and the department cannot object to such assessment, but he has to furnish his own estimate of income in Form No. 28A – *Punjab Tractors Ltd. v. CIT (2004) 137 Taxman 211 (Punjab & Haryana)*.

For higher estimate made by the assessee, Form 28A is not required to be furnished.

The AO will find out the current income on the following basis:

- (i) Total income of the latest previous year in respect of which the assessee has been assessed by way of regular assessment;
- (ii) The total income returned by the assessee for any previous year subsequent to the previous year for which regular assessment is made. whichever is higher;

AO can revise his order passed under Section 210(3) [Section 210(4)]

If after making the order under section 210(3), but before 1st March (a) a return has been furnished by the assessee, (b) a regular assessment of the assessee is made, in respect of a later previous year, for a higher figure, then the Assessing officer may revise or amend his order.

On receipt of the order the assessee have to pay the advance tax accordingly.

Illustration

Calculate Advance Tax Payable by Arun from the following estimated incomes for the previous year 2013-14:

- Business Income: ₹ 4,50,000;
- Rent from house property: ₹ 36,000 per month;
- Municipal taxes: ₹ 27,000;
- Winning from games: ₹ 70,000 (net of TDS);
- Life insurance premium paid for himself (sum assured: ₹ 5,00,000): ₹ 30,000;

Solution

Computation of Advance Tax payable by Arun for Previous Year 2013-14 (Assessment Year 2014-15)

Step 1: Compute Estimated Total Income for the year:

Particulars	₹	₹
Income from house property:		
Gross Annual Value [Rental Income (36,000 x 12)]	4,32,000	
Less: Municipal taxes paid by owner	<u>(27,000)</u>	
Net Annual Value (NAV)	4,05,000	
Less: Standard Deduction @ 30% of NAV	<u>(1,21,500)</u>	2,83,500
Profits and gains of Business or Profession		4,50,000

Income from other sources:

Winning from games (gross) [70000 x 100/100 – 30%]	1,00,000
Gross Total Income (GTI)	8,33,500
Less: Deductions under Section 80C	(30,000)
Total Income	8,03,500

Step 2: Computation Estimated of Tax Liability and Advance Tax Payable

Particulars	₹	₹
Tax on:		
Winning from Games @ 30% [1,00,000 x 30%]	30,000	
Balance Income @ Slab Rate [30,000 + 20% of (7,03,000 - 5,00,000)]	70,700	
Tax payable		1,00,700
Add: Surcharge, if any		Nil
Add: Cess @ 3%		3,021
Tax Liability		1,03,721
Less: TDS		(30,000)
Advance Tax Liability		73,721
Advance Tax (rounded off)		73,720

Step 3: Advance tax instalments - Advance tax is payable as follows:

Upto		Cumulative	Each instalment
	%	₹	₹
15.09.2013	30	22,116 [73,720x30%]	22,116
15.12.2013	60	44,232 [73,720x60%]	22,116
15.03.2014	100	73,720 [73,720x100%]	29,488

Illustration

Red Ltd. (an Indian company) has estimated its income for previous year 2013-14. Calculate advance tax payable by it from the following :

- Business Income: ₹ 10,80,000;
- Income from house property (after deduction under section 24): ₹ 7,20,000;
- Long term capital gain (LTCG) on transfer of immovable property on 1st November, 2013: ₹ 3,60,000;
- Interest on bank deposits (other than saving bank account): ₹ 45,000.
- TDS on business income and interest was ₹ 60,000
- Deduction under section 80G is ₹ 1,00,000.

Solution**Computation of advance tax payable by Red Ltd. for Previous Year 2013-14 (Assessment Year 2014-15):**

Step 1: Compute Estimated total income for the year:

Particulars	₹	₹
Profits and gains of Business or Profession		10,80,000
Income from house property		7,20,000
LTCG		3,60,000
Income from other sources:		
Interest on bank deposits		<u>45,000</u>
Gross Total Income (GTI)		22,05,000
Less: Deductions under Section 80G		<u>(1,00,000)</u>
Total Income		<u>21,05,000</u>

Step 2: Computation of Estimated Tax Liability and Advance Tax Payable

Particulars	₹	₹
Tax on:		
LTCG @ 20% ($3,60,000 \times 20\%$)	72,000	
Balance Income @ 30% [$(21,05,000 - 3,60,000) \times 30\%$]	<u>5,23,500</u>	5,95,500
Add: Surcharge, if any		Nil
Add: Cess @ 3%		<u>17,865</u>
Tax Liability		6,13,365
Less: TDS		<u>(60,000)</u>
Advance Tax Liability		5,53,365
Advance Tax (rounded off)		5,53,370

Step 3: Advance Tax Instalments - Advance Tax is payable as follows:

Note: Advance Tax is payable by a Corporate Assessee in four instalments during the previous year i.e. by 15th June (15%), 15th September (45%), 15th December (75%) and 15th March (100%). However, in case of LTCG arising after one or more instalments, advance tax on instalments prior to date of LTCG can be paid without including tax on LTCG and advance tax on instalments after LTCG must be paid in the remaining instalments on the amount of total tax liability including that on LTCG.

Therefore, in this case, advance tax payable by 1st and 2nd instalment would be based on Tax excluding Tax on LTCG and advance tax payable by 3rd and 4th instalment would be based on tax including tax on LTCG.

Tax excluding tax on LTCG: ₹ 5,23,500 + Cess @ 3% = 5,39,205 - TDS ₹ 60,000 = ₹ 4,79,205 [₹ 4,79,210 after rounding off]

Upto	Cumulative		Each instalment
	%	₹	₹
15.06.2013	15	71,882 [4,79,210x15%]	71,882
15.09.2013	45	2,15,645 [4,79,210x45%]	1,43,763
15.12.2013	75	4,15,028 [5,53,370x75%]	1,99,383
15.03.2014	100	5,53,370 [5,53,370x100%]	1,38,342

REFUNDS (SECTIONS 237 to 245)

Refund means “to repay” or restore what was taken under the income-tax law. Refunds arise in those cases where the amount of tax paid by a person or on his behalf is greater than the amount with which he is properly chargeable for that year. Under the following circumstances the refunds may become due:

- (i) The tax deducted at source is higher than the amount of tax payable, as determined on regular assessment;
- (ii) The amount of advance tax paid or tax paid on the basis of self- assessment exceeds the tax payable as determined on regular assessment;
- (iii) The tax determined and paid on the basis of regular assessment gets reduced as a result of rectification of mistake which had crept in the assessment or is reduced in appeal or revision;
- (iv) The same income is taxed in India and in a foreign country and the assessee is entitled to double taxation relief.

For claiming refund it is necessary that the income in respect of which refund of tax is being claimed must have been included in his total income as per the return of Income.

Every claim for refund under this chapter shall be made in the prescribed Form (No. 30) within one year from the last day of the assessment year to which the claim is related. If the assessee has not filed the return of income he must file the return alongwith the certificate/s of tax deducted at source, challans for payment of tax, salary certificate and/or tax paid in a foreign country. The dividend warrants and other certificates should be filed in original, duly signed by the assessee, to evidence the ownership of shares etc., from which the income is derived. If, for some reason, the original certificates are not traceable, duplicates issued by the concerned companies may be furnished. However, in such cases an indemnity bond stating that the original certificates are not traceable and no refund in respect of such warrants had already been claimed, should also accompany the claim. Indemnity bond should be on a stamp paper of the prescribed value depending upon the amount of tax deduction.

Where refund arises on completion of assessment on account of excess payments of advance tax or on self-assessment or it results on account of reduction in appeal, revision or rectification of mistakes, no formal application for refund is required. The Assessing Officer shall grant such refund on his own. However, where an assessment is set aside or cancelled by virtue of such an order and an order of fresh assessment is directed to be made, the refund if any, shall become due only on the making of fresh assessment. In cases where the assessment is annulled, the refund shall become due only of the amount of tax paid in excess of the tax chargeable on the total income returned by the assessee (Section 240).

However, the assessing officer is authorised to admit a belated refund claim subject to satisfying the following conditions:

- (a) the refund arising as a tax deducted at source under Section 192, 193, 194, 194A, 194B, 194C, 194D

- and 195 or as a result of excess advance tax payments under Section 208, does not exceed ₹ 10,000;
- (b) the returned income is not a loss, where the assessee claims the benefit of carry forward of the loss;
 - (c) the refund claimed is not supplementary in nature i.e. a claim for additional amount of refund after the completion of the original assessment for the same year; and
 - (d) the income of the assessee is not assessable in the hands of any other person under any provisions of the Act.

Whom to apply for refund?

Claim for refund should be preferred to the Assessing Officer having jurisdiction to assess the assessee.

In bigger towns like Delhi, Bombay, Calcutta, Madras, separate Refund Circles have been opened to settle refund cases. However, these circles settle refund cases where income is restricted to 'Other Sources'.

Who is entitled to refund

Any one of the following persons can apply for the refund:

- (i) Owner of the income who has made excess payment;
- (ii) Where the income of a person is included in the hands of another, only the latter is entitled to refund;
- (iii) In case of death of the assessee, his legal representative;
- (iv) In case of insolvency of the assessee - the receiver;
- (v) In case of liquidation of a company - the liquidator of the company;
- (vi) In case of minor or incapable assessee - the guardian of the minor or incapable;
- (vii) In case of non-resident assessee - his agent provided he has been duly authorised by the principal; and
- (viii) In case of dissolved partnership firm - any partner provided he has been duly authorised by all other ex-partners of the firm.

Issue of Refund

If the Assessing Officer is satisfied that the refund claim is complete and in order, he shall complete the assessment and issue a refund voucher payable at the Reserve Bank or the State Bank or any treasury. The refund voucher is encashable like any other cheque, within three months from the date of issue. If the assessee fails to encash it within the prescribed time (3 months from the date of issue), he should send it to the Assessing Officer who will cancel it and issue a fresh one. If the applicant is a resident and the amount of refund is small, the amount may be sent by money order at Government cost. Where the assessee is a non-resident, generally a Bank Draft is sent at his cost.

Adjustment of Refund

All refunds may not be settled by actual payments. Wherever it is found that tax for some other years (either earlier or subsequent to the year to which the refund relates) are outstanding against the assessee, the refund due may be adjusted against the outstanding demand and the balance, if any, refunded to him. However, the amount can be adjusted only after giving an intimation in writing to the assessee of the action proposed to be taken for the purpose.

Interest on Refunds

Section 244A, provides that where, in pursuance of any order passed under the Income-tax Act, refund of any amount becomes due to the assessee, he shall be entitled to receive, in addition to the said amount, simple interest thereon calculated in the following manner:

- (a) Where the refund is out of any tax collected at source under Section 206C or paid by way of advance tax or treated as paid under Section 199, during the financial year immediately preceding the assessment year, interest calculated at the rate of one half per cent for every month or part of a month comprised in the period from 1st day of April of the assessment year to the date on which the refund is granted. But, if the amount of refunds is less than ten per cent of the tax as determined on regular assessment, no interest shall be payable.

However, no interest shall be payable if the amount of refund is less than ten percent of the tax as determined under Sub-section (1) of Section 143 or regular assessment.

- (b) In any other case, such interest has to be calculated at the rate of one half per cent for every month or part of a month comprised in the period or periods from the date or dates of payment of the tax or penalty to the date on which the refund is granted (The “date of payment of tax or penalty” means the date on and from which the amount of tax or penalty; specified in the demand notice under Section 156 is paid in excess of such demand).
- (c) The assessee is not entitled to any interest on refund where a delay in payment thereof takes place for reasons attributable to the assessee. Any question as to the period to be excluded has to be decided by the Chief Commissioner or Commissioner whose decision thereon shall be final.
- (d) In the event of increase or reduction of the amount on which the interest is payable (as a consequence of an order 143(3); 144; 147; 154; 155; 250; 254; 260; 262; 263; 264; or 245D(4), interest payable is to be increased or reduced accordingly. In the case of subsequent reduction of the interest, the Assessing Officer has to serve a demand notice on the assessee requiring him to pay back such amount as has been paid in excess.

The provisions of this section shall apply in respect of assessments for the assessment year commencing on the 1st day of April, 1989 and subsequent years. However, in respect of assessment of fringe benefits, the provisions of this Sub-section shall have effect as if for the figures “1989”, the figures “2006” had been substituted.

INTEREST FOR BELATED PAYMENT OF INCOME-TAX [Section 220(2)]

An assessee is liable to pay interest @ 1% for every month or part thereof comprised in the period intervening between the expiry of 30 days w.e.f. serving of the notice of demand and actual payment of tax for the delay in making the payment of tax demanded beyond 30 days from the date of receipt of the demand notice.

Sub-section (2A) of Section 220, empowers the Board to reduce or waive the amount of interest payable by an assessee under the above section on the recommendation made by the Chief Commissioner or Commissioner in this behalf. The Board's order will be passed only upon satisfaction that:

- (a) the payment of such interest has caused or would cause genuine hardship to the assessee;
- (b) the default in the payment of the amount on which interest has been paid or was payable was due to circumstances beyond the control of the assessee; and
- (c) the assessee has co-operated in any enquiry relating to the assessment or any proceeding for recovery of any amount due from him.

INTEREST FOR DEFAULT IN FURNISHING RETURN OF INCOME (Section 234A)

In cases where a return on income is furnished after the due date or is not furnished at all, the assessee has to pay simple interest at the rate of 1% per cent for every month or part of the month of default on the amount of tax on the total income as determined under sub-section (1) of Section 143, and where a regular assessment is made, on the amount of the tax or the total income determined under regular assessment or reduced by an amount of (1) advance tax if paid; (2) any TDS/TCS; (3) any relief under Sections 90, 90A; (4) any deduction under Sections 91; (5) any tax credit under the provisions of Section 115JAA.

The period for which the interest is payable commences from the date immediately following the due date for filing the return and ending on the date of furnishing of the return. Where the return is not furnished, the interest will be payable from the due date for filing the return till the date of completion of assessment.

INTEREST FOR DEFAULT IN PAYMENT OF ADVANCE TAX (Section 234B)

Where the assessee, liable to pay advance tax, has not remitted the same or Where the advance tax paid is less than 90 per cent of assessed tax

He has to pay simple interest on assessed tax means the tax on the total income determined under subsection(1) of section 143 and where a regular assessment is made, the tax on the total income determined under such regular assessment as reduced by the amount of (1) advance tax, if any paid; (2) any TDS/TCS; (3) any relief under Sections 90, 90A; (4) any deduction under Section 91; (5) any tax credit under provision of Section 115JAA @1% percent for every month or part of month from 1st day April next following such financial year to the date of determination of total income under section 143(1) and where a regular assessment is made, to the date of such regular assessment. .

In cases where the assessee has paid tax on the basis of self assessment under Section 140A, before the date of completion of a regular assessment, the interest is calculated on above basis upto the date of payment of tax under Section 140A and, the thereafter, on the amount by which the advance tax and tax paid under Section 140A fall short of advance tax.

In the cases of enhancement or reduction of the amount on which interest was payable under Section 147 (income escaping assessment) or Section 153A;

Section 154 (rectification of mistake); Section 155 (other amendments on completed assessment of a partner in a firm; member of an AOP or body of individuals etc.); Section 250 (appeal); Section 254 (orders of the Appellate Tribunal); Section 260 (Decision of High Court or Supreme Court on the case stated; Section 262 (hearing before Supreme Court); Section 263 (revision of orders prejudicial to revenue); Section 264 (Revision of orders); or 245D(4) [order of the Settlement Commission, the interest shall be increased or reduced correspondingly. Where the interest has already been paid to the assessee, a notice of demand, calling for payment of such amount, has to be served on the assessee by the Assessing Officer. Such notice of demand shall be deemed to be an order under Section 156 of the Act.

INTEREST FOR DEFERMENT OF ADVANCE TAX (Section 234C)

If the assessee (non-corporate assessee)

If the assessee (non-corporate assessee) who is liable to pay advance tax under Section 208 has failed to pay such tax or has underestimated the instalments of advance tax, he has to pay interest as follows:

- (i) If advance tax paid on or before 15 September is less than 30% of tax due on total income declared in the return filed by the assessee, the assessee shall pay simple interest @ 1% per month for a period of three months on the amount of the shortfall from thirty per cent of the tax due on the returned income.
- (ii) If advance tax paid on or before 15 December is less than 60% of tax on total income declared in the return, the assessee shall pay simple interest @ 1% per month for a period of three months on the amount of the shortfall from sixty per cent of the tax due on the returned income.
- (iii) If advance tax paid on or before March 15 is less than 100% of tax due on total income declared in the return, as reduced by tax deducted at source, simple interest is payable @ 1% per month on the amount of shortfall from the tax due on the returned income declared.

If the assessee (corporate assessee)

If the assessee (corporate assessee) who is liable to pay advance tax under Section 208 has failed to pay such tax or has underestimated the instalments of advance tax, he has to pay interest as follows:

- (i) If advance tax paid on or before 15 June is less than 15% of tax due on total income declared in the return or If advance tax paid on or before 15 September is less than 45% of tax due on total income declared in the return filed by the assessee or If advance tax paid on or before 15 December is less than 75% of tax due on total income declared in the return the assessee shall pay simple interest @ 1% per month for a period of three months on the amount of the shortfall from 15%, 45%, and 75% of the tax due on the returned income.
- (iii) If advance tax paid on or before March 15 is less than 100% of tax due on total income declared in the return, as reduced by tax deducted at source, simple interest is payable @ 1% per month on the amount of shortfall from the tax due on the returned income declared.

The following explanation shall be substituted w.e.f. 1.4.2007, namely:

Explanation: in this section “tax due on the returned income” means the tax chargeable on the total income declared in the return of income furnished by the assessee for the assessment year commencing on the 1st day of April immediately following the financial year in which the advance tax is paid or payable, as reduced by the amount of,- (1) any TDS/TCS (2) any relief of tax under Section 90 or 90A (3) any deduction under Section 91 (4) any tax credit u/s 115JAA.”

INTEREST RECEIVABLE BY THE ASSESSEE

SECTION 244A (INTEREST ON REFUNDS)

- (a) If the amount of refund is not less than ten per cent of the tax as determined on regular assessment, and the refund is out of any tax collected at source under Section 206C or treated as paid under Section 199, during the financial year immediately preceding the assessment year, interest shall be payable at the rate of $\frac{1}{2}$ per cent for every month or part of a month comprised in the period from 1st day of April of the assessment year to the date on which the refund is granted;
- No interest shall be payable if the amount of refund is less than ten percent of the tax as determined under 143(1) on regular assessment.
- (b) in any other case, at the rate of one half per cent for every month or part of the month comprised in the period or periods from the date or, dates of payment of the tax or penalty to the date of grant of refund.

The “date of payment of tax or penalty” means the date on and from which the amount of tax or penalty specified in the notice of demand issued under Section 156 is paid in excess of such demand.

However, where the proceedings resulting in the refund are delayed for reasons attributable to the assessee, whether wholly or partly, the period of delay so attributable to him shall be excluded as per the decision taken by the Chief Commissioner or Commissioner (his decision thereon shall be final).

In the cases of enhancement or reduction of the amount on which interest was payable under Section 143 (Assessment); Section 144 (Best Judgement Assessment); Section 147 (income escaping assessment); Section 154 (rectification of mistake); Section 155 (other amendments on completed assessment of a partner in a firm; member of an AOP or body of individuals etc.); Section 250 (appeal); Section 254 (orders of the Appellate Tribunal); Section 260 (decision of High Court or Supreme Court on the case stated); Section 262 (hearing before Supreme Court); Section 263 (revision of orders prejudicial to revenue); Section 264 (revision of other orders); or 245D(4) (order of the Settlement Commission), the interest shall be increased or reduced correspondingly. Where the interest has already been paid to the assessee, a notice of demand, calling for

payment of such amount, has to be served on the assessee by the Assessing Officer. Such notice of demand shall be deemed to be an order under Section 156 of the Act.

Any payment of advance tax payable made before March 31 shall be treated as advance tax paid during the financial year.

In case of public holiday or bank holiday, date of payment automatically falls in the next working day and for that delay, interest is not charged under Sections 234B and 234C vide Circular No. 676 dated 14.01.1994.

Tax to be computed at the prevailing rate on the current income of the assessee, in a financial year.

LESSON ROUND UP

- The Income-tax Act provides for collection and recovery of income-tax in the following ways, namely,
 - (i) deduction of tax at source in respect of income by way of salaries, interest on securities, interest other than interest on securities, winnings from lotteries and crossword puzzles, winnings from horse-race, insurance commission, dividends, payment to contractors or subcontractors and payments to non-residents;
 - (ii) advance payment of income-tax before the assessment by the assessee himself;
 - (iii) direct payment of income-tax by the assessee on self-assessment; and
 - (iv) after the assessment is made by the Assessing Officer.
- Sections 192 to 206 of the Income-tax Act lay down the provisions relating to deduction of tax at source.
- Section 197A provides that no deduction of tax at source is to be made from (i) interest on securities, (ii) dividends, and (iii) payments in respect of deposits under NSS, etc. if the following conditions are satisfied:
 - (i) The recipient of such income is an individual and resident in India.
 - (ii) Such person furnishes a declaration in writing in duplicate, in the prescribed form and verified in the prescribed manner, to the payer of such income to the effect that the tax on his estimated total income of the previous year in which such income is to be included for computing his total income will be nil.
- Section 207-219 of the Income Tax Act deals with the issues relating to advance payment of tax. In advance payment of tax, the assessee has to pay tax in a financial year under estimated income which is to be taxed in the subsequent assessment year. It follows the doctrine known as pay as you earn scheme.
- It is obligatory for an assessee to pay advance tax where the advance tax payable is ₹10,000 or more (Section 208).
- Refund means “to repay” or restore what was taken under the income-tax law. Refunds arise in those cases where the amount of tax paid by a person or on his behalf is greater than the amount with which he is properly chargeable for that year.

SELF TEST QUESTIONS

These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation.

MULTIPLE CHOICE QUESTIONS

1. In which of the following cases tax is required to be deducted at source?
 - (a) Interest credited or paid by a co-operative society to its members
 - (b) Interest paid by a bank on the savings account balance.
 - (c) Interest paid by an individual to a bank on housing loan
 - (d) Interest paid by a bank on fixed deposit
2. Under Payment in respect of Deposits under National Savings Scheme, Section 194EE, deduction shall not be made if the amount of payment or the aggregate of payment to the payee during the financial year is less than _____.
 - (a) ₹ 1,500
 - (b) ₹ 2,500
 - (c) ₹ 3,500
 - (d) ₹ 4,500
3. What maximum amount of rent payment does not require deduction of tax at source per financial year?
 - (a) ₹ 60,000
 - (b) ₹ 90,000
 - (c) ₹ 1,20,000
 - (d) ₹ 1,80,000
4. Which of the following relates to the meaning of 'rent'?
 - (a) Payment under lease
 - (b) Payment under purchase
 - (c) Payment under sub-lease
 - (d) Payment under tenancy

TRUE AND FALSE

1. If a person responsible for deduction of tax at source fails to deduct the appropriate tax, or after making the due deduction fails to deposit it into the Government treasury, he is liable to prosecution.
2. In case of winnings from lotteries and crossword puzzles under Section 194B, 30% income-tax will be deducted from the prize given only in kind.
3. It is obligatory for an assessee to pay advance tax where the amount of tax payable is ₹ 5000 or more.

ELABORATIVE

1. Describe briefly the procedures regarding collection and recovery of Tax by the authorities.
 2. What is Tax deducted at Source?
 3. Explain the procedures regarding refund of excess tax paid by the assessee to the Department.
 4. State the provisions regarding deduction of tax at source in respect of the following incomes:
 - (i) Rent
 - (ii) Professional or technical fees.
 - (iii) Winning from horse races.

ANSWERS/HINTS

Multiple Choice Question

1. (d); 2 (b); 3 (d); 4 (a), (c) and (d)

True/False

1. False; 2. False; 3. False

SUGGESTED READINGS

1. Dr. V.K. Singhania : Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.
 2. Girish Ahuja and Ravi Gupta : Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.
 3. Dr. V.K. Singhania & Dr. Kapil Singhania : Professional Approach to Direct Taxes Law & Practice; Bharat Law House, New Delhi.
 3. Dr. V.K. Singhania & Dr. Kapil Singhania : Direct Taxes Law & Practice; Taxmann Publications Pvt. Ltd., New Delhi.

Lesson 11

Procedure for Assessment

LESSON OUTLINE

- Income-Tax Authorities (Appointment, Jurisdiction and Powers) (Section 116)
- Appointment of Income-tax Authorities (Section 117)
- Control of Income-tax Authorities (Section 118)
- The Central Board of Direct Taxes
- Appointment and Working of the Board
- Jurisdiction
- Power
- Jurisdiction of Income-tax Authorities (Section 120)
- Director-General or Director of Income-tax
- Chief Commissioner or Commissioner of Income-tax
- Commissioner of Income-tax (Appeals)
- Return of Income [(Section 139(1))]
- Signing of Return (Section 140)
- Permanent Account Number (Section 139A)
- Types of Assessment
- Reference to Dispute Resolution Panel (Section 144C)
- Rectification of mistakes [Section 154]
- Lesson Round Up
- Self Test Questions

LEARNING OBJECTIVES

The provisions of the Income-tax Act contained in Sections 117 to 136 specify the procedure relating to the appointment of the various income-tax authorities, their powers, functions, jurisdiction and control. The procedure under the Income-tax Act for making an assessment of income begins with the filing of a return of income. Section 139 of the Act contains the relevant provisions relating to the furnishing of a return of income. Filing of return is the first step of assessment. On the basis of return of income the income tax authority makes the assessment.

At the end of this lesson, you will learn;

- Various income-tax authorities, their powers, functions, jurisdiction and control.
- What are the provisions of Filing of Return of Income
- How to file Return of income.
- What are the provisions for E-Filing of Return.
- What are the due dates for filing of ROI.
- What is the need of PAN
- What are the types of assessment
- When can order for re-assessment be issued.
- How the mistake in return can be rectified and by whom.
- When can application be made to Dispute Resolution Panel.

Digital Signature Certificate (DSC) is an electronic signature that can be used to authenticate the identity of the sender of a message or the signer of a document and it is equivalent of a hand written signature. An assessee can use a DSC to file their return/form.

INCOME-TAX AUTHORITIES (APPOINTMENT, JURISDICTION AND POWERS) (SECTION 116)

The following are the income-tax authorities who are statutorily empowered to administer the law of Income-tax:

- (i) The Central Board of Direct Taxes, constituted under the Central Boards of Revenue Act, 1963;
- (ii) Directors-General of Income-tax or Chief Commissioners of Income-tax;
- (iii) Directors of Income-tax or Commissioners of Income-tax or Commissioners of Income-tax (Appeals);
- (iv) Additional Directors of Income-tax or Additional Commissioners of Income-tax or Additional Commissioners of Income-tax (Appeals);
- (v) Joint Directors of Income tax or Joint Commissioners of Income-tax.
- (vi) Deputy Directors of Income-tax or Deputy Commissioners of Income-tax or Deputy Commissioners of Income-tax (Appeals);
- (vii) Assistant Directors of Income-tax or Assistant Commissioners of Income-tax;
- (viii) Income-tax (Assessing) Officers;
- (ix) Tax Recovery Officers;
- (x) Inspectors of Income-tax.

The provisions of the Income-tax Act contained in Sections 117 to 136 specify the procedure relating to the appointment of the various income-tax authorities, their powers, functions, jurisdiction and control. In addition to the various provisions contained in these sections, the Income-tax Department follows the system of functional allocation and distribution of work with a view to specialising and concentrating in the various areas of income-tax assessment, procedure, collection, recovery, refund, appeals, etc.

For all purposes of the Income-tax Act, the Income Tax authorities are vested with the various powers which are vested in a Court of Law under the Code of Civil Procedure while trying a suit in respect of any case. More particularly, the provisions of the Code of Civil Procedure and the powers granted to the tax authorities under the code would in respect of:

- (a) discovery and inspection;
- (b) enforcing the attendance, including any officer of a bank and examining him on oath;
- (c) compelling the production of books of accounts and the documents;
- (d) collecting certain information [Section 133B - inserted by the Finance Act, 1986];
- (e) issuing commissions and summons.

The Finance Act, 1985 has added that w.e.f. 1.4.1973 every income-tax authority shall be deemed to be a Civil Court for the purposes of Section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973. The powers granted are generally quasi-judicial. In particular, the powers of income-tax authorities relate to discovery, production of evidence etc., searches and seizures, application of retained assets, power to call for information from various parties, authorities and bodies, powers of survey, powers relating to the inspection of the registers of companies etc. Further, all proceedings under the Income-tax Act before any income-tax authority must be deemed to be judicial proceedings within the meaning of Sections 193 and 228 and for purposes of Section 196 of the Indian Penal Code. For a detailed Study of the various powers, functions, jurisdiction, etc., of the different classes of income-tax authorities and the general scheme of administration of the Income-tax Act, students may refer to the relevant provisions of the Income-tax Act.

Appointment of Income-tax Authorities (Section 117)

The Central Government may appoint such persons as it thinks fit to be income-tax authorities. Where an income-tax authority is authorised by the Board, it may appoint such executive or ministerial staff as may be necessary to assist it in the execution of its function.

Control of Income-tax Authorities (Section 118)

The Board is empowered to control the income-tax authorities. It may notify that any income-tax authority will be sub-ordinate to such other income-tax authority or authorities as may be specified in the notification.

THE CENTRAL BOARD OF DIRECT TAXES (CBDT)

Appointment and Working of the Board

The Central Board of Direct Taxes was created under the Central Boards of Revenue Act, 1963 [Section 2(12)]. The Board in its working is closely associated with the Ministry of Finance.

Jurisdiction

It is the topmost executive authority in the sphere of direct taxes. Its powers of administration supervision and control extend over the whole department.

Power

- (i) **Power to make Rules:** It has the power to make rules (under Section 295) for carrying out the purposes of this Act. The Rules may be made for whole or any part of India.
- (ii) **To issue instructions:** It may issue orders, instructions and directions to all officers and persons employed in the execution of the Act (Section 119). However, it cannot interfere with the discretion of the Commissioner (Appeals), in the exercise of the appellate functions [Section 119(1)(b)] and it cannot direct the Assessing Officer or any other income-tax authority to make a particular assessment or to dispose of a particular case in a particular manner [J.K. Synthetics Ltd. v. CBDT (1972) 83 ITR 335 (SC)] [Section 119(1)(a)].
- (iii) **Power to relax mandatory provisions:** The Board is empowered to relax the provision relating to the charge of mandatory interest for defaults in deduction of tax at source, or payment of such tax [under Section 201(1A)] or payment of advance tax (Section 211) or interest for defaults in furnishing return (Section 234A) or interest for defaults in payment of advance tax (under Section 234B or Section 234C) or assessment and recovery of tax.
- The Board is also empowered to relax the provisions relating to the computation of total income and deductions to be made in computing total income in cases of genuine hardship. It can be done by a general or special order and for reasons to be specified therein.
- (iv) **Power to admit belated refund application:** To avoid genuine hardship in any case or class of cases, the Board may authorise any income-tax authority, not being Commissioner (Appeals) to admit belated application or claim for any exemption, deduction, refund or any other relief [Section 119(2)(b)].
- (v) **Power to decide jurisdiction:** The Board is empowered to decide jurisdictional matters of any income-tax authority and assign to them such functions as are to be performed by them (Section 120).
- (vi) **Power to disclose information:** The Board may disclose information relating to any assessee, to any officer, authority, or body performing any functions under any tax law relating to the imposition of any tax, duty or cess or dealing in foreign exchange under Foreign Exchange Management Act, 1999, if it considers such disclosure in public interest. The Board may also authorise any other income-tax authority

to disclose such information (Section 138). The provision is intended to facilitate exchange of information about tax evaders.

Director-General or Director of Income-tax

He has the following powers:

- (a) ***To appoint an income-tax authority below the rank of an Assistant Commissioner (Section 117):*** If so authorised by the Central Government a Director-General or Director may appoint an income-tax authority below the rank of Assistant Commissioner.
- (b) ***To delegate the powers of Assessing Officer to Joint Commissioner (Section 120):*** Where Director-General or Director is so authorised by the Board, he may delegate the powers and functions of the Assessing Officer to Joint Commissioner.
- (c) ***To transfer cases (Section 127):*** The Director-General may transfer any case from one or more Assessing Officers subordinate to him to any other Assessing Officer also subordinate to him.
- (d) ***Enquiry into concealment [Section 131(1A)]:*** If the Director-General or Director or Deputy Director or Assistant Director (w.e.f. 1.6.1988) has reason to suspect that any income has been concealed, or is likely to be concealed, by any person or class of persons, within his jurisdiction, he is empowered to make any enquiry or investigation relating thereto notwithstanding that no proceedings with respect to such person or class of persons are pending before him [Section 131(1A)].
- (e) ***Search and seizure [Section 132(1)]:*** Where the Director-General or Director or Chief Commissioner or Commissioner in consequence of information in his possession has reason to believe that (a) any person to whom notice has been issued in respect of discovery and inspection etc. [under Section 131(1)] or (b) any person to whom notice has been issued to produce accounts or documents [under Section 142(1)], has failed to do so far he is not likely to produce such accounts or documents, or (c) any person is in possession of undisclosed income or property, he is empowered [under Section 132(1)] to authorise any Deputy Director, Deputy Commissioner, Assistant Director (Assistant Commissioner w.e.f. 1.4.1989) or Assessing Officer to enter and search any building, place, vessel, vehicle or aircraft, where he has reason to suspect about their availability and seize any such books of accounts, other documents, money, bullion, jewellery or other valuable article or thing found as a result of such search.
- (f) ***To requisition books of account/Assets etc. (Section 132A):*** Where any books of account or documents have been taken into custody by any officer or authority under any other law (e.g. by Commissioner or Customs, Sales Tax Commissioner etc.) and the Director General or Director or the Chief Commissioner or Commissioner, in consequence of information in his possession, has reason to believe that (i) any person, required to produce such accounts/documents prior to their acquisition under any other law, has failed to do so, or (ii) such accounts or documents will be useful for any proceeding under income-tax law but such person would not produce them on their return by the officer or authority under any other law, or (iii) any assets represent income or property which has not been, or would not have been disclosed by any person from whose possession or control such assets have been taken into custody by any officer or authority under any other law, he may authorise any Deputy Director, Deputy Commissioner, Assistant Director, Assistant Commissioner or Income-tax Officer to require such officer or authority under any other law to deliver such books of account or documents or such assets to the requisitioning officer under income-tax law. On a requisition being made, such officer or authority under any other law is required to deliver such books of accounts or documents or assets to the requisitioning officer either forthwith or after such time when it is no longer necessary to retain them in his custody.
- (g) ***To make any enquiry (Section 135):*** The Director-General or Director is competent to make any enquiry under this Act.

Chief Commissioner or Commissioner of Income-tax

He has the following powers:

- (i) **To appoint an income-tax authority below the rank of Assistant Commissioner (Section 117):** If so authorised by the Central Government, a Chief Commissioner or Commissioner may appoint an income-tax authority below the rank of Assistant Commissioner.
- (ii) **To delegate the powers of Assessing Officer to Deputy Commissioner (Section 120):** Where Chief Commissioner or Commissioner is so authorised by the Board, he may delegate the powers and functions of the Assessing Officer to Joint Director or Joint Commissioner.
- (iii) **To transfer case (Section 127):** The Chief Commissioner or Commissioner is empowered to transfer any case from any Assessing Officers to any other Assessing Officer or Assessing Officers.
- (iv) **Power regarding discovery, production of evidence etc. (Section 131):** The Chief Commissioner or Commissioner has the same powers as are vested in a Court under the Code of Civil Procedure in respect of discovery and inspection, compelling production of books of accounts and other documents (relating to any period), issuing commissions enforcing the attendance of any person, including any officer of a banking company and examining him on oath.

The Commissioner may impound or retain any books of accounts or other documents produced before him for such time as he thinks fit [Section 131(3)]. Where such power is exercised by the Assessing Officer, he has to record reasons before impounding the books of accounts or documents. The Assessing Officer or Assistant Commissioner cannot retain the books of accounts/documents for a period exceeding 15 days without prior approval of the Chief Commissioner or Director-General or Commissioner [Section 131(3)].

- (v) **Search and seizure (Section 132):** Like Director-General or Director, the Chief Commissioner or Commissioner of Income-tax has also got the powers of search and seizure.
- (vi) **To requisition books of accounts etc. (Section 132A):** Like Director-General or Director of Income-tax, the Chief Commissioner or Commissioner is also vested with the power to requisition books of accounts.
- (vii) **Power of survey (Section 133A):** An income-tax authority (i.e. Commissioner, Joint Commissioner, Deputy Commissioner, Director, Joint Director, Deputy Director, Assistant Director or an Assessing Officer) is empowered to enter any place, within the limits of the area assigned to him, where business is carried on or where any books of accounts/documents, cash, stocks or other valuable articles relating to business are kept. An income-tax authority may (a) place marks of identification on the books of accounts or other documents inspected by him and make or cause to be made extracts or copies therefrom, or (b) make an inventory of any cash, stock or other valuable articles or things checked or verified by him, or (c) record the statement of any person which may be useful or relevant to any proceeding under this Act. Books of accounts or other documents, any cash, stock or other valuable articles cannot be removed by the income-tax authority from such place. The entry (a) to a business place should be made during the hours at which such place is open for the conduct of the business, and (b) to any other place only after sun rise and before sun set. An entry to a place not falling within the jurisdiction of an income-tax authority, should be made with the prior approval of that income-tax authority who exercises jurisdiction over that place.

Where an assessee incurs an ostentatious expenditure on any function, ceremony, the income-tax authority is empowered to collect information about such expenditure from the assessee or any other person who is likely to possess information in this connection and may record their statement which may be used thereafter as an evidence. This may be done at time such function or ceremony is over.

- (viii) **To make any enquiry (Section 135):** The Chief Commissioner or Commissioner is competent to make any enquiry under this Act.
- (ix) **Disclosure of information respecting assessee (Section 138):** Where a person makes an application to the Chief Commissioner or Commissioner in the prescribed form for any information relating to any assessee in respect of any assessment, he may furnish the information asked for in respect of that assessment if he satisfied that such disclosure is in public interest.
- (x) **To sanction reopening of the assessment after the expiry of four years [Section 151(2)]:** The assessment of an income which has escaped assessment can be reopened after the expiry of four years from the end of the relevant assessment year only if the Chief Commissioner or Commissioner has sanctioned such reopening.
- (xi) **To approve withholding of refund in certain cases (Section 241):** Where any proceeding is pending against the assessee and the Assessing Officer is of the opinion that the grant of the refund may adversely affect the revenue, the Chief Commissioner or Commissioner may authorise the Assessing Officer to withhold the refund till such time as the Chief Commissioner or Commissioner may determine.
- (xii) **Set-off of refund against arrears of tax (Section 245):** The Chief Commissioner or Commissioner is empowered to set off the amount of refund or any part thereof due to any person against the arrears of the tax due from such person. Any intimation in writing to this effect should be given to such person.
- (xiii) **To direct the Assessing Officer to prefer appeal to the Tribunal against A.A.C.'s order [Section 253(2)]:** The Commissioner may, if he objects to any order passed by a Commissioner (Appeals), direct the Assessing Officer to appeal to the Appellate Tribunal against the order.
- (xiv) **To revise any order passed by the Assessing Officer which is prejudicial to revenue (Section 263):** The Commissioner may revise any order passed by the Assessing Officer which is prejudicial to the interest or revenue.
- (xv) **Revision of any order passed by a subordinate authority on application by the assessee or suo motu (Section 264):** The Commissioner may revise either on his own motion or on an application made by the assessee within the prescribed time for such revision, any order passed by an authority subordinate to him. He may pass such order thereon, not being an order prejudicial to the assessee as he may think fit.

Commissioner of Income-tax (Appeals)

The Commissioner of Income-tax (Appeals) is an appellate authority. It is vested with the judicial powers:

- (1) **Power regarding discovery, production of evidence (Section 131):** Like Chief Commissioner or Commissioner, the power regarding discovery, production of evidence etc., can also be exercised by the Commissioner (Appeals).
- (2) **Power to call for information (Section 133):** The Commissioner of Income-tax (Appeals) may, for the purposes of this Act:
 - (a) require any firm to furnish him with a return of the names and addresses of the partners of the firm and their respective shares;
 - (b) require any Hindu Undivided Family to furnish him with a return of the names and addresses of the manager and the members of the family;
 - (c) require any person whom he has reason to believe to be a trustee, guardian or agent, to furnish him with a return of the names of the persons for or of whom he is trustee, guardian or agent, and of their addresses;

- (d) require any assessee to furnish a statement of the names and addresses of all persons to whom he has paid in any previous year rent, interest, commission, royalty or brokerage, or any annuity together with particulars of such such payments made;
 - (e) require any dealer, broker or agent or any person concerned in the management of a stock or Commodity Exchange to furnish a statement of the names and addresses of all persons to whom he or the Exchange has paid any sum in connection with the transfer, whether by way of sale, exchange or otherwise, of assets, or on whose behalf or from whom he or the Exchange has received any such sum, together with particulars of all such payments and receipts;
 - (f) require any person, including a banking company or any officer thereof, to furnish information in relation to such point or matter or to furnish statements of accounts and affairs verified in the specified manner, giving such information as may be required by him.
- (3) **Power to inspect register of companies (Section 134):** The Commissioner (Appeals) may inspect and, if necessary, take copies or cause copies to be taken, of any register of members, debenture holders or mortgagees of any company or of any entry in such register. The Commissioner (Appeals) may also authorize (in writing) any person subordinate to him to inspect and, if necessary, take copies or registers as aforesaid.
- (4) **Set-off of refund against arrears of tax (Section 245):** The Commissioner (Appeals) is empowered to set off the amount of refund or any part thereof due to any person against the arrears of tax due from such person. Intimation in writing to this effect should be given to such person.
- (5) **Disposal of appeal (Section 251):** In disposing of an appeal, the Commissioner (Appeals) has the following powers:
- (a) in an appeal against an order of assessment he may confirm, reduce, enhance or annual the assessment, or he may set aside the assessment and refer back to the Assessing Officer for making a fresh assessment in accordance with such directions as given by him.
 - (b) in an appeal against an order imposing a penalty, he may confirm or cancel such order or vary it so as either to enhance or reduce the penalty.
 - (c) in any other case, he may pass such order in appeals as he thinks fit.
- It may be noted that an assessment or a penalty cannot be enhanced or the amount of refund cannot be reduced unless the appellant had a reasonable opportunity of showing cause against such enhancement or reduction.
- (6) **Imposition of penalty (Section 271):** The Commissioner (Appeals) may impose penalty for not producing the books of accounts or other documents [Section 142(1)] or for concealment of income (under Section 271).

Jurisdiction of Income-tax Authorities (Section 120)

Income-tax authorities are required to exercise or perform such powers or functions as are assigned to them by the Board [Section 120(1)].

Any income-tax authority, being an authority higher in rank, may, if so directed by the Board exercise the powers and performs the functions of the income-tax authority lower in rank and any such direction issued by the Board shall be deemed to be a direction issued under Sub-section (1).

The Board may authorise any other income-tax authority to issue orders in writing for the exercise of the powers and performance of the functions by all or any of the income-tax authority who are subordinate to it [Section 120(2)]. While issuing such directions, the Board or any other income-tax authority authorised by it may take into

account (i) territorial area, (ii) persons or classes of persons, (iii) incomes or classes of income, and (iv) cases or classes of cases [Section 120(3)].

RETURN OF INCOME [(SECTION 139(1)]

The procedure under the Income-tax Act for making an assessment of income begins with the filing of a return of income. Section 139 of the Act contains the relevant provisions relating to the furnishing of a return of income. According to that section, it is statutorily obligatory for every person being a company or a firm or being a person other than a company or firm to furnish a return of his total income or the total income of any other person in respect of which he is assessable under the Income-tax Act, in all cases where his total income or the total income of any other person for which he is liable to be assessed exceeds, in any relevant accounting year, the maximum amount which is not chargeable to income-tax. The return of income must be furnished by the assessee in the prescribed manner by the Board from time to time.

It should be obligatory for the firm to file return of income in every case. Further, in respect of individual, HUF, AOP, BOI, Artificial juridical Person, filing of return of income shall be compulsory if their total income before allowing deductions under Sections 10A, 10B, 10BA or chapter VI-A exceeds the maximum amount which is not chargeable to income tax.

Compulsory filing of Income Tax return in relation to assets located outside India

From assessment year 2012-13, it is mandatory to file a return of income where a person, being a resident other than not ordinarily resident in India and who during the previous year has any asset (including any financial interest in any entity) located outside India or signing authority in any account located outside India.

In such a case, it is immaterial that the taxable income is less than the maximum amount not chargeable to tax.

Exemption from filing of Return of Income

CBDT has clarified vide Press Release [No. 402/92/2006-MC (15 of 2012)], dated 20-7-2012 that under what conditions exemption from filing of return is available.

Exemption is available to salaried employees from the requirement of filing the returns for A.Y. 2012-13. The exemption is applicable only if all the following conditions are fulfilled: -

- Employee has earned only salary income and income from savings bank account and the annual interest earned from savings bank account is less than ₹10 thousand.
- The total Income of the employee does not exceed ₹ 5 Lakh (Total Income means Gross Total Income Less deductions under Chapter VIA).
- The Employee has reported his PAN to the employer.
- Employee has reported his income from interest on savings bank account to employer.
- Employee has received Form 16 from his employer.
- Total Tax Liability of employee has been paid off by employer by way of TDS and employer has deposited TDS with central government.
- Employee has no refund claim.
- Employee has received salary only from one employer.
- Employee has not received any Notice from Income Tax Department for filing of Income Tax return.

Due date for filing return of income

The assessee is obliged to voluntarily file the return of income without waiting for the notice of the Assessing

Officer calling for the filing of the return.

The time limit for filing of the return by an assessee if his total income of any other person in respect of which he is assessable exceeds the maximum amount not chargeable to tax, shall be as follows:

- (a) where the assessee is –
 - (i) a company,
 - (ii) a person, other than a company whose accounts are required to be audited under the Income-tax Act or any other law, for the time being in force,
 - (iii) a working partner of a firm whose accounts are required to be audited under this Act or under any law for the time being in force, the 30th day of September of the Assessment Year.
- (b) In the case of an assessee being a company, which is required to furnish a report referred to in section 92E, the 30th day of November of the assessment year.
- (c) in the case of any other assessee, the 31st day of July of the Assessment Year.

E-filing of Return

Filing of Income Tax Returns is a legal obligation of every person who total for the previous year exceeds the exemption limit provided under the Income Tax Act, 1961. The Income Tax Department has introduced on line facility in addition to conventional method to file return of income. The process of electronically filing of Income Tax return through the mode of internet access is called e-filing of return. E-filing offers convenience of the tax payers. The only obligation for the user of this facility is to have a PAN number. There are eight forms from ITR-I to ITR-8 for e-filing of returns. There is a provision e-filing for digital signature by the assessee.

Bulk Filing of Return

Finance Act, 2002 has introduced a new scheme of Bulk Filing of Return vide new Section 139(1A). According to the new provisions, any person, being an individual who is in receipt of income chargeable under the head "Salaries" may, at his option, furnish a return of his income for any previous year to his employer, in accordance with such scheme as may be specified by the Board in this behalf. The employer shall furnish all returns of income received by him on or before the due date, in such form (including on a floppy, diskette, magnetic cartridge tape, CD-ROM or any other computer readable media) and manner as may be specified in that scheme, and in such case, any employee who has filed a return of his income to his employer shall be deemed to have furnished a return of income under

Section 139(1) and the provisions of this Act shall apply accordingly.

However, the following returns of employees cannot be submitted under the above schemes:

- I. return of a year other than the current year;
- II. return without PAN;
- III. return under Block assessment;
- IV. return of an employee having more than one employer.

Power to Central Government

Section 139(1C) empower the Central Government to exempt any class or classes of persons from the requirement of furnishing a return of income by issue notification in the Official Gazette.

RETURN OF LOSS- SECTION 139(3)

The requirements of Income-tax Act making it obligatory for the assessee to file a return of his total income even in cases where the assessee has incurred a loss under the head 'profits and gains from business or profession' or loss from maintenance of race horses or under the head 'Capital gains'. Unless the assessee files a return of loss in the manner and within the same time limits as required for a return of income, the assessee would not be entitled to carry forward the loss for being set off against income in the subsequent year.

BELATED RETURN – SECTION 139(4)

Any person who has not filed the return within the time allowed under section 139(1) or within the time allowed under a notice issued by the Assessing Officer under section 142(1) may file a belated return

- at any time before the expiry of one year from the end of the relevant assessment year or
- before the completion of the assessment

whichever is earlier.

Example: For the previous year 2013-14, Mr. X did not file the return of income on the due date. Can Mr. X file the return of income after the due date?

Correct answer: Yes, As per section 139(4), Mr. X can file a belated return. Mr. X may file the return of income at any time on or before 31st of March 2016 (one year from the end of the Assessment Year 2014-15).

RETURN OF INCOME OF CHARITABLE TRUST AND INSTITUTIONS – SECTION 139(4A)

Sub-section (4A) of Section 139 also makes it incumbent of "every person in receipt of income derived from property held under trust or other legal obligation wholly for charitable or religious purposes or in part only for such purposes or of income being voluntary contributions within the meaning of Section 2(24)(iia)" to furnish a return of income in case the total income exceeds the maximum amount not chargeable to tax.

Further, one who is assessable as a representative assessee for the receipt of income derived from property held under Trust or other legal obligation wholly for charitable or religious purposes or in part only for such purposes or of income being voluntary contributions shall furnish a return of income of the previous year in the prescribed form and get it verified in such manner as prescribed under Section 139(1), if the total income (without giving effect to the provisions of Sections 11 and 12) exceeds the amount not chargeable to tax.

RETURN OF INCOME OF POLITICAL PARTY- SECTION 139(4B)

It is also incumbent on the political parties to file their return of income [if the income (without giving effect to the provisions of Section 13A) exceeds the maximum amount not chargeable to tax], duly signed by the Chief Executive Officer of the party

RETURN OF INCOME OF SPECIFIED ASSOCIATION/INSTITUTIONS- SECTION 139(4C)

Before introducing a new Section 139(4C) to the Act, there was an ambiguity about filing of return by certain categories of persons who are availing the exemption from income tax. Now this issue is solved with effect from assessment year 2003-04 and the following persons are required to file the return:

- (a) Research association referred to in Section 10(21);
- (b) news agency referred to in Section 10(22B);
- (c) association or institution referred to in Section 10(23A);
- (d) institution referred to in Section 10(23B);

- (e) fund or institution referred to in Section 10(23C)(iv), (v), (vi) or (via);
- (f) trade union referred to in Section 10(24)(a) or 10(24)(b),
- (g) body or authority or Board or Trust or Commission in section 10(46)
- (h) infrastructure debt fund referred to in section 10(47)

The above persons shall, if the total income, without giving effect to the provisions of Section 10, exceeds the maximum amount which is not chargeable to income-tax, furnish a return of such income of the previous year in the prescribed form and verified in the prescribed manner and setting forth such other particulars as may be prescribed and all the provisions of this Act shall, so far as may be, apply as if it were a return required to be furnished under Section 139(1)".

REVISED RETURN- SECTION 139(5)

An assessee who is required to file a return of income is entitled to revise the return of income originally filed by him to make such amendments, additions or changes as may be found necessary by him. Such a revised return may be filed by the assessee at any time

- before the expiry of one year from the end of the relevant assessment year
- before the completion of assessment

whichever is earlier.

DEFECTIVE RETURN-SECTION 139(9)

If the Assessing Officer considers that the return of income furnished by the assessee is defective, he may intimate the defect to the assessee and give him an opportunity to rectify the defect within 15 days from the date of such intimation or within such further period as may be allowed by the Assessing Officer on the request of the assessee. If the assessee fails to rectify the defect within the aforesaid period, the return shall be deemed to be invalid and further it shall be deemed that the assessee had failed to furnish the return. However, where the assessee rectifies the defect after the expiry of the aforesaid period but before the assessment is made, the Assessing Officer may condone the delay and treat the return as a valid return.

If the self assessment tax is not paid on or before the date of furnishing the return of income, return shall be considered as defective return.

A return of income shall be regarded as a defective return unless all the following conditions are fulfilled:

- (a) the annexures, statements and columns in the return of income relating to computation of income chargeable under each head of income, computation of gross total income and total income have been duly filled in;
- (b) the return is accompanied by a statement showing the computation of tax payable on the basis of return as well as the report of audit obtained under Section 4AB;
- (c) the return is accompanied by proof of:
 - (i) the tax, if any, claimed to have deducted at source and the advance tax and tax on self-assessment, if any, claimed to have been paid;
 - (ii) the amount of compulsory deposit, if any, claimed to have been made (The scheme has been abolished w.e.f. 1.4.1985).

But a return shall not be called defective where it is not accompanied by proof of the tax, if any, claimed to have been deducted at source, if:

- (a) a certificate for tax deducted was not furnished under Section 203 to the person furnishing his return of income;

- (b) such certificate is produced within a period of two years specified under Sub-section (14) of Section 155".
- (d) where the regular books of account are maintained by the assessee, the return is accompanied by copies of:
 - (i) manufacturing account, trading account, profit and loss account or income and expenditure account or any similar account and balance sheet;
 - (ii) in the case of proprietary business or profession, the personal account of the proprietor; in the case of a firm, association of persons or body of individuals, personal accounts of the partners or members; and in the case of a partner or member of a firm, association of persons or body of individuals, also his personal account in the firm, association of persons or body of individuals.
- (e) where the accounts of the assessee have been audited, the return is accompanied by copies of the audited profit and loss account and balance sheet and auditors' report; and where an audit of cost accounts of the assessee has been conducted under Section 233B of the Companies Act, 1956 also the report under that section.
- (f) where regular accounts are not maintained by the assessee, the return is accompanied by a statement indicating the amounts of turnover or gross receipts, gross profit, expenses and net profit of the business or profession and the basis of which such amounts have been computed, and also disclosing the amounts of total sundry debtors, sundry creditors, stock-in-trade and cash balance as at the end of the previous year.

Note: Not relevant now as the assessee has to furnish annexure less return of income from assessment year 2007-08 and onwards.

NEW SCHEME TO FACILITATE SUBMISSION OF RETURNS THROUGH TAX RETURN PREPARERS [SECTION 139B] [W.E.F. 1-6-2006]

W.e.f. 1.6.2006, a new section 139B have been inserted in the Act so as to provide that for the purpose of enabling any specified class or classes of persons to prepare and furnish returns of income, the Board may, by way of notification, frame a scheme providing that such persons may furnish their returns of income through a Tax return preparer authorized to act as such under the scheme. This scheme is not applicable for a company or a person who is required to undergo a 'tax audit' or 'audit under any other law'.

It has been further provided that the Scheme framed under the said section shall specify the manner in which the Tax return preparer shall assist the persons furnishing the return of income, and shall also affix his signature on such return.

A Tax return preparer may be an individual other than a person referred to in clause (ii) or clause (iii) or clause (iv) of sub-section (2) of section 288 or an employee of the specified class or classes of persons, who has been authorized to act as a Tax return preparer under this Scheme.

In other words, the following persons are not authorized to act as Tax return preparer:

- any officer of a scheduled bank in which the assessee maintains a current account or has regular dealings.
- A legal practitioner; or
- A chartered accountant.

The Scheme notified under the said section shall provide the manner in which a Tax return preparer shall be authorized, the educational and other qualifications to be possessed, and the training and other conditions required to be fulfilled, by a person to act as a Tax return preparer, the code of conduct for the Tax return

preparer, the duties and obligations of the Tax return preparer, the manner in which the authorization may be withdrawn and any other matter which is required to be or may be specified.

SIGNING OF RETURN (SECTION 140)

The return of income must be signed and verified:

- (a) In the case of an individual,
 - (i) by the individual himself;
 - (ii) where he is absent from India, by the individual himself or by some person duly authorised by him in this behalf;
 - (iii) where he is mentally incapacitated from attending to his affairs, by his guardian or any other person competent to act on his behalf; and
 - (iv) where, for any other reason, it is not possible for the individual to sign the return, by any person duly authorised by him in this behalf:

Provided that in a case referred to in Sub-clause (ii) or (iv), the person signing the return holds a valid power of attorney from the individual to do so, which shall be attached to the return:

- (b) in the case of a H.U.F. by the Karta, and, where the karta is absent from India or mentally incapacitated from attending to his affairs, by any other adult member of such family;
- (c) in the case of a local authority, the Principal Officer thereof;
- (d) in the case of a firm, by managing partner thereof or where for any unavoidable circumstances such managing partner is not able to sign and verify the return, or where there is no managing partner as such, by any partner thereof, not being a minor;
- (e) in the case of a limited liability partnership, by the designated partner thereof, or where for any unavoidable reason such designated partner is not able to sign and verify the return, or where there is no designated partner as such, by any partner.
- (f) in the case of any other association, by any member of the association or Principal Officer thereof;
- (g) in the case of any other person, by that person or some person competent to act on his behalf;
- (h) in the case of a company; by the managing director thereof, or where for any unavoidable reason such managing director is not able to sign the return or where there is no managing director, by any director thereof.

Provided that where the company is not resident in India, the return may be signed and verified by a person who holds a valid power of attorney from such company to do so, which shall be attached to the return:

Provided further that –

- (a) where the company is being wound up, whether under the order of a court or otherwise, or where any person has been appointed as the receiver of any assets of the company, the return shall be signed and verified by the liquidator referred to in Sub-section (1) of Section 178;
- (b) where the management of the company has been taken over by the Central Government or any State Government under any law, the return of the company shall be signed and verified by the Principal Officer thereof;
- (i) in the case of a political party referred to in Sub-section (4B) of Section 139, by the Chief Executive

Officer of such party whether such Chief Executive Officer is known as secretary or by any other designation.

PERMANENT ACCOUNT NUMBER (SECTION 139A)

Every person, who has not been allotted any permanent account number, is obliged to obtain permanent account number, if:

- if his total income assessable during the previous year exceeds the maximum amount which is not chargeable to tax or
- any person carrying on business or profession whose total sales turnover or gross receipts are or is likely to exceed ₹5,00,000 in any previous year or
- is required to furnish a return of income under Section 139(4A)

Besides above cases, the Assessing Officer may also allot a permanent account number to any other person by whom tax is payable. Any other person may also apply for a permanent account number. However, Section 139 has been amended w.e.f. August 1, 1998 and provides the alternative of quoting GIR (General Index Register) number till such time the permanent account number is allotted.

POWER DELEGATED TO CENTRAL GOVERNMENT

The Central Government may, by notification in the Official Gazette, specify, any class or classes of persons by whom tax is payable under this Act or any tax or duty is payable under any other law for the time being in force including importers and exporters whether any tax is payable by them or not and such persons shall, within such time as mentioned in that notification, apply to the Assessing Officer for the allotment of a permanent account number.

QUOTING OF PAN

It shall be the duty of every person who has been allotted permanent account number to quote such number in all his returns or correspondence with Income tax authorities, quote such numbers in all challans for the payment of any sum, quote such number in all documents pertaining to such transactions as may be prescribed by the Board in the interest of revenue.

Now quoting PAN is compulsory in the following transactions:

- (a) Sale/purchase of any immovable property valued at ₹ 5 lakhs or more.
- (b) Sale/Purchase of Motor vehicle or a vehicle (excluding two wheeled vehicle, inclusive of any detachable side-car having an extra wheel) which requires registration under Motor Vehicles Act, 1988.
- (c) Time deposit exceeding ₹ 50,000 with a Bank/Banking Company/Banking Institution.
- (d) Deposit exceeding ₹ 50,000 in Post Office Savings Bank.
- (e) Contract for sale/purchase of securities exceeding ₹ 1 lakh.
- (f) Opening an account [not being time deposit mentioned in (c)] with a Bank/Banking Company/Banking Institution.
- (g) Application for installation of a telephone connection including mobile phone.
- (h) Payments to hotels of bills exceeding ₹ 25,000/- at any one time.
- (i) Payment in cash for purchase of bank drafts or pay orders or banker's cheque for an amount of ₹ 50,000 or more during any one day.

- (j) Deposit in cash aggregating ₹50,000 during any one day.
- (k) Payment in cash in connection with travel to any foreign country of an amount exceeding ₹25,000 at any one time.
- (l) Making an application to any banking company or to any other company or institution for issue of a credit or debit card.
- (m) Payment of an amount of ₹50,000 or more to a Mutual Fund for purchase of its units.
- (n) Payment of ₹50,000 or more to a company for acquiring shares or debentures or bonds issued by it.
- (o) Payment of ₹50,000 or more to RBI for acquiring bonds issued by it.
- (p) Payment of an amount of ₹50,000 or more as life insurance premium to an insurer.
- (r) Payment to a dealer
 - (i) of an amount of ₹5 lakh or more at any one time, or
 - (ii) against a bill for an amount of ₹5 lakh or more for purchase of bullion or jewellery.

Every person, receiving any document relating to the prescribed transactions, shall ensure that the permanent account number has been duly quoted in the document. The Board has been empowered to make rules in relation to the form and the manner in which the application for the allotment of a permanent account number and the particulars which such application will contain, prescribing the categories of transactions and the categories of documents pertaining to business or profession in which the permanent account numbers shall have to be quoted by every person.

The “permanent account number under the new series” has been defined to mean a number which will have ten alphanumeric characters to be issued on a laminated card.

The expression “Assessing Officer” has been defined to include an income tax authority to whom the job of allotting permanent account numbers has been assigned.

TYPES OF ASSESSMENT

- (a) Self assessment (Section 140A)
- (b) Regular assessment (Section 143)
- (c) Best judgement assessment (Section 144)
- (d) Income escaping assessment or re-assessment (Section 147)
- (e) Precautionary assessment.

(A) SELF ASSESSMENT (SECTION 140A)

Self assessment is the first step in the process of assessments. Self Assessment is simply a process where a person himself assesses his tax liability on the income earned during the particular previous year and submits Income Tax Return to the department. Every person, before furnishing return under sections 139(return of income), 142(1), 148 (issue of notice where income has escaped assessment) and 153A (Assessment in case of search or requisition) shall make self assessment of his income and pay the tax, if due on the basis of such assessment. The total tax payable is calculated on the total income of the assessee after considering the following amount:

- (i) the amount of tax already paid under any provision of this Act;
- (ii) any tax deducted or collected at source;

- (iii) any relief of tax or deduction of tax claimed under section 90 or section 91 on account of tax paid in a country outside India;
- (iv) any relief of tax claimed under section 90A on account of tax paid in any specified territory outside India referred to in that section; and
- (v) any tax credit claimed to be set off in accordance with the provisions of section 115JAA.

Such determined value of tax along with the interest payable under any provision of this Act for any delay in furnishing the return or any default or delay in payment of advance tax is paid before furnishing the return and the proof of payment of such tax is attached with the return.

The work of income tax department became easy due to the system of Self Assessment.

INQUIRY BEFORE ASSESSMENT UNDER SECTION 142 OR 142A

1. Issue of notice to the assessee to submit return(if not submitted earlier):

The existing provisions contained in section 142(1)(i), inter alia, provide that for the purpose of making assessment in a case where a person has not made a return of his income within the time specified under sub-section (1) of section 139, the Assessing Officer may serve a notice under sub-section on such a person requiring him to furnish the return of his income in the prescribed form and manner.

Clause (i) of sub-section (1) has been amended so as to provide that in a case where a person has not made a return of his income before the end of the relevant assessment year, the Assessing Officer may serve a notice after the end of the relevant assessment year under said sub-section requiring such person to furnish his return of income.

The Assessing Officer may ask to produce, or cause to be produced, such accounts or documents and to furnish in writing and verified in the prescribed manner information in such form and on such points or matters (including a statement of all assets and liabilities of the assessee, whether included in the accounts or not). However, the previous approval of the Joint Commissioner shall be obtained before requiring the assessee to furnish a statement of all assets and liabilities not included in the accounts. Further, the Assessing Officer shall not require the production of any accounts relating to a period more than three years prior to the previous year.

2. Make Inquiry and give opportunity of being heard u/s 142(2):

For the purpose of obtaining full information in respect of the income or loss of any person, the Assessing Officer may make such inquiry as he considers necessary

3. Give direction to get books of accounts audited u/s 142(2A) to (2D):

Having regard to the nature and complexity of the accounts volume of the accounts, doubts about the correctness of the accounts, multiplicity of transaction in the accounts or specialised nature of Business activity of the assessee and the interests of the revenue, assessing officer is of the opinion that it is necessary to order audit then with the previous approval of the Chief Commissioner or Commissioner the Assessing Officer may direct an assessee to get his accounts audited by an accountant even if the accounts have earlier been audited.

The Assessing Officer shall not direct the assessee to get the accounts audited unless the assessee has been given a reasonable opportunity of being heard.

Every report under sub-section (2A) shall be furnished by the assessee to the Assessing Officer within the period as specified by the Assessing Officer.

However, the Assessing Officer may, suo motu, or on an application made in this behalf by the assessee and for any good and sufficient reason, extend the said period by such further period or periods as he thinks fit but shall not exceed 180 days from the date on which the direction under sub-section (2A) is received by the assessee.

The expenses of, and incidental to, such audit (including the remuneration of the Accountant) shall be determined by the Chief Commissioner or Commissioner in accordance with such guidelines as may be prescribed and the expenses so determined shall be paid by the Central Government.

Summary assessment/Intimation to the assessee u/s 143(1)

Under summary assessment, Assessing Officer completes the assessment without passing a regular assessment order. The Assessing Officer issue an acknowledgement/intimation under section 143(1) of tax payable or refundable as the case may be on the basis of Return of Income filed by the assessee under section 139 or in response to a notice issued under section 142(1). The Assessing Officer (AO) processes the return in the following manner:

- (1) The total income or loss after making adjustments for any arithmetical error in the return or for any incorrect claim which is apparent from any information in the return is calculated.
- (2) Then the tax and interest, if any, on the basis of the total income computed in step (1) is computed.
- (3) Now following adjustments are made to the tax and interest calculated above to determine the sum payable by the assessee or any amount of refund due to him:
 - tax deducted at source,
 - any tax collected at source,
 - any advance tax paid,
 - any relief allowable under an agreement under section 90, 90A and 91,
 - any rebate allowable under Part A of Chapter VIII,
 - any tax paid on self-assessment and
 - any amount paid otherwise by way of tax or interest;
- (4) The AO shall prepare or generate intimation and send it to the assessee specifying the sum determined to be payable by, or the amount of refund due to the assessee.
- (5) The amount of refund due to the assessee shall be granted to the assessee.

Since no assessment order is issued by the department for legal purposes the intimation/acknowledgement shall not be considered as assessment.

Time limit for intimation under section 143(1):

No intimation for tax or interest due under section 143(1) shall be sent after the expiry of 1 year from the end of financial year in which return of income is made.

Example:

For the assessment year 2014-15, Mr. Rajan files the ITR on 25th July 2014. Intimation under section 143(1) may be sent up to 31st March 2016.

(b) SCRUTINY (REGULAR) ASSESSMENT [SECTION 143(2) & (3)]

Where a return has been made under Section 139, or in response to a notice under Sub-section (1) of Section 142, the Assessing Officer shall, if he considers necessary or expedient to ensure that the assessee has not understated the income or has not computed excessive loss or has not underpaid the tax in any manner, serve on the assessee a notice requiring him, on a date to be specified therein, either to attend his office or to produce, or cause to be produced there, any evidence on which the assessee may rely in support of the return:

Provided that no notice under this sub-section shall be served on the assessee after the expiry of six months from the end of the Financial year in which the return is furnished.

On the day specified in the notice issued under Sub-section (2), or as soon afterwards as may be, after hearing such evidence as the assessee may produce and such other evidence as the Assessing Officer may require on specified points, and after taking into account all relevant material which he has gathered, the Assessing Officer shall, by an order in writing, make an assessment of the total income or loss of the assessee, and determine the sum payable by him or refund of any amount due to him on the basis of such assessment.

(c) BEST JUDGEMENT ASSESSMENT U/S 144

The Assessing Officer, after taking into account all relevant material which he has gathered, and after giving the assessee an opportunity of being heard, makes the assessment of the total income or loss to the best of his judgment and determine the sum payable by the assessee on the basis of such assessment in the following cases:

- If any person fails to make the return required under section 139(1) and has not made a return or a revised return under section 139(4) or 139(5), or
- When a person fails to comply with all the terms of a notice issued under section 142(1) or fails to comply with a direction issued under section 142(2A) for getting the accounts audited, or
- If any person having made a return, fails to comply with all the terms of a notice issued under section 143(2).

Prior to the proceedings the AO should issue a show cause notice to the assessee. However if the assessee has already issued notice under section 142(1)(i) and the assessee has not complied with the terms then AO can proceed further without issuing a show cause notice.

Further AO cannot assess the income below returned income and cannot assess losses higher than the returned losses. A refund cannot be granted under section 144.

The assessing officer can also reject the accounts book under section 145 and can make best judgment assessment under section 144 if:

- The accounts books are incorrect, false or incomplete.
- If the accounting method employed is such that the profit cannot be derived from it correctly.
- Where the method of accounting adopted by the assessee is not followed by him regularly.
- If the assessee has not followed the accounting standards notified by the government.

Note : From 1st day of April, 2014 section 144BA shall be omitted.

(d) INCOME ESCAPING ASSESSMENT OR RE-ASSESSMENT (SECTION 147)

If the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may, subject to the provisions of sections 148 to 153,

- assess or reassess income which has escaped assessment or
- recompute the loss or the depreciation allowance or any other allowance, as the case may be for the relevant assessment year.

Section 147, the Assessing Officer shall serve on the assessee a notice requiring him to furnish, within such period, as may be specified in the notice, a return of his income or the income of any other person in respect of which he is assessable under this Act during the previous year corresponding to the relevant assessment year, in the prescribed form, and verified in the prescribed manner and setting forth such other particulars, as may be

prescribed; and the provisions of this Act shall, so far as may be, apply accordingly as if such return were a return furnished as per the requirements of Section 139.

Provided that in a case

- (a) where a return has been furnished during the period commencing on the 1st day of October, 1991 and ending on the 30th day of September, 2005 in response to a notice served under this section, and
- (b) subsequently a notice has been served under Sub-section (2) of Section 143 after the expiry of twelve months specified in the proviso to Sub-section (2) of Section 143, as it stood immediately before the expiry of the time limit for making the assessment, reassessment or re-computation as specified in sub-section (2) of Section 153, every such notice referred to in this clause shall be deemed to be a valid notice.

The following shall also be deemed to be cases where income chargeable to tax has escaped assessment, namely :

- (i) where no return of income has been furnished by the assessee although his total income or the total income of any other person in respect of which he is assessable under this Act during the previous year exceeded the maximum amount which is not chargeable to income-tax
- (ii) where a return of income has been furnished by the assessee but no assessment has been made and it is noticed by the Assessing Officer that the assessee has understated the income or has claimed excessive loss, deduction, allowance or relief in the return
- (iii) where the assessee has failed to furnish a report in respect of any international transaction which he was so required under section 92E
- (iv) where an assessment has been made, but
 - (i) income chargeable to tax has been under assessed ; or
 - (ii) such income has been assessed at too low a rate ; or
 - (iii) such income has been made the subject of excessive relief under this Act ; or
 - (iv) excessive loss or depreciation allowance or any other allowance under this Act has been computed;]
- (v) where a person is found to have any asset (including financial interest in any entity) located outside India.

The assessing officer before making the assessment under this section will have to issue notice u/s 148 to the assessee requiring him to file the return even if he has already filed the return under section 139 or 142(1). The AO is duty bound to provide the assessee the reasons recorded by him, if the assessee request for it. If on request the reasons are not supplied then AO cannot proceed the assessment. The time limit for issue of notice under section 148 is as under:

Cases	<i>Upto 4 years from the end of relevant assessment year</i>	<i>Beyond 4 years but upto 6 years from the end of the relevant assessment year.</i>
Where assessment order passed u/s 143(3) or 147.	<ul style="list-style-type: none"> (i) Notice can be issued for any amount of escaped income. (ii) Notice can be issued by Assistant Commissioner or Deputy Commissioner and by AO with the approval of Joint Commissioner. 	<ul style="list-style-type: none"> (i) Notice can be issued only if escaped income is of ₹ 100,000 or more. (ii) Notice can be issued by the AO only with the approval Chief Commissioner or Commissioner.

Where no assessment order has been passed u/s 143(3) or 147.	Notice can be issued by AO whatever be the amount.	Notice can be issued by the AO only with the approval Joint Commissioner only when the amount is likely to be ₹100,000 or more for that year.
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However, the time limit of 6 years is not sufficient in cases where assets are located outside India because gathering information regarding such assets takes much more time on account of additional procedures and laws of foreign jurisdictions. Therefore, the time limit for issue of notice for reopening an assessment has been increased to 16 years, where the income in relation to any asset (including financial interest in any entity) located outside India, chargeable to tax, has escaped assessment.

TIME LIMIT FOR COMPLETION OF ASSESSMENTS AND REASSESSMENTS (SECTION 153)

(1) *Section 153(1) deals with time limit for completion of Assessment/Re-Assessment made under section 143 and 144:*

When Assessment is made for the Assessment year 2010-11 or any Subsequent Assessment year, time limit for completion of such Assessment is **2 years** from the end of the relevant Assessment Year in which income was first assessable. However, where reference has been made to Transfer Pricing officer under section 92CA(1) during the course of proceeding for the assessment of total income such period for completion of assessment shall be 3 years.

(2) *Section 153(2) deals with time limit for completion of Assessment/Re-Assessment under section 147 (Income Escaping Assessment):*

The time limit for completion of Assessment/Re-Assessment is 1 year from end of the Financial Year in which notice under section 148 was served on the Assessee.

Where reference is made to the Transfer Pricing officer under section 92CA(1) during the course of proceeding such period shall be 2 years for completion of assessment.

(3) *Section 153(2A) deals with assessment where original assessment has been cancelled or set aside by the Appellate Authority under section 250 (Procedure in hearing), 254 (Order of Appellate Tribunal) or by Commissioner of Income Tax under section 263 (Revision of Orders, Prejudicial to Revenue), 264 (Revision of Orders in favour of Assessee):*

The Time limit for completion of Assessment/Re-Assessment is 1 year from end of the Financial Year in which

- (a) Such order of set aside or cancelling the order is passed by the Appellate Authority under section 250 or 254 received by commissioner of Income Tax.
- (b) Order under section 263 or 264 was passed by the Commissioner of Income Tax.

However, if reference was made to Transfer Pricing Officer under section 92CA(1) during the course of proceeding such period shall be 2 years for completion of assessment.

Note : The Commissioner (Appeals) cannot cancel or set aside the Assessment and refer the case to the Assessing Officer for fresh assessment. However, it can be set aside by ITAT or Commissioner under section 263 or 264.

(4) *Section 153(4) deals with the cases where any Proceeding initiated or order of assessment/re-assessment made under 153A(1) [relating to assessment of search cases] has been annulled in an appeal or in other legal proceedings and assessment/re-assessment relating to assessment year which was abated has been revived:*

In such case the time limit for completion of Assessment/Re-Assessment is 1 year **from end of the month of**

such revival or within the time specified in section 153 or section 153B(1) [prescribe time limit for completion of assessment under section 153A] whichever is **later**.

Computation of Period of limitation

In computing the period of limitation for this purpose, the time taken in the following cases shall be excluded:

- (i) the time taken in re-opening the whole or part of the proceeding or in giving an opportunity to the assessee to be re-heard under section 129;
- (ii) the period during which the assessment proceeding is stayed by an order or injunction of any court;
- (iii) the period commencing from the date on which the Assessing Officer directs the assessee to get his accounts audited under section 142(2A) and ending with the last date on which the assessee is required to furnish a report of such audit or where such direction is challenged before a court, ending with the date on which order is setting aside the date on which such direction is received by the commissioner;
- (iv) the period (not exceeding 60 days) commencing from the date on which the declaration under Section 158A(1) is received by the Assessing Officer and ending with the date on which the order thereunder is made by him;
- (v) where an application made before the Income-tax Settlement Commission is rejected by it, the period commencing from the date on which application is made and ending with the date on which the order is received by the Chief Commissioner or Commissioner.
- (vi) the period commencing from the date on which an application is made before the Authority for Advance Rulings under sub-section (1) of section 245Q and ending with the date on which the order rejecting the application is received by the Commissioner under sub-section (3) of section 245R, or
- (vii) the period commencing from the date on which an application is made before the Authority for Advance Rulings under sub-section (1) of section 245Q and ending with the date on which the advance ruling pronounced by it is received by the Commissioner under sub-section (7) of section 245R; or
- (viii) the period commencing from the date on which reference or first of the references for the exchange of information is made by the authority competent under an agreement referred to in section 90 or section 90A and ending with the date on which the information requested is last received by the commissioner or a period of one year whichever is less; or

(e) Precautionary Assessment

Where it is not clear as to who has received the income and *prima facie*, it appears that the income may have been received either by A or by B or by both together, the Assessing Officer can commence proceedings against both A and B to determine the question as to who is responsible to pay the tax [Lalji Haridas v. I.T.O. (1961) 43 ITR p. 387 (S.C.)].

REFERENCE TO DISPUTE RESOLUTION PANEL (SECTION 144C)

The Assessing Officer shall, forward a draft order of assessment to the eligible assessee if he proposes to make, on or after the 1st day of October, 2009, any variation in the income or loss returned which is prejudicial to the interest of such assessee.

On receipt of the draft order, the eligible assessee shall, within thirty days of the receipt by him of the draft order.

- (a) file his acceptance to the Assessing Officer, or
- (b) file his objections with

- (i) the Dispute Resolution Panel; and
- (ii) the Assessing Officer

The Assessing Officer shall complete the assessment on the basis of the draft order, if the assessee intimates to the Assessing Officer the acceptance of the variation or no objections are received.

The Assessing Officer shall, notwithstanding anything contained in section 153, pass the assessment order under sub-section (3) within one month from the end of the month in which the acceptance is received or the period of filing of objections expires.

The Dispute Resolution Panel shall, in a case where any objection is received, issue such directions for the guidance of the Assessing Officer to enable him to complete the assessment.

The Dispute Resolution Panel shall issue the directions after considering draft order, objections filed by the assessee, evidence furnished by the assessee, report of the Assessing Officer, Valuation Officer or Transfer Pricing Officer or any other authority, records relating to the draft order, evidence collected by it and result of any enquiry made by it.

The Dispute Resolution Panel may confirm, reduce or enhance the variations proposed in the draft order however it shall not set aside any proposed variation or issue any direction for further enquiry and passing of the assessment order.

If the members of the Dispute Resolution Panel differ in opinion on any point, the point shall be decided according to the opinion of the majority of the members.

Every direction issued by the Dispute Resolution Panel shall be binding on the Assessing Officer.

No direction shall be issued unless an opportunity of being heard is given to the assessee and the Assessing Officer on such directions which are prejudicial to the interest of the assessee or the interest of the revenue.

No direction shall be issued after nine months from the end of the month in which the draft order is forwarded to the eligible assessee.

Upon receipt of the directions the Assessing Officer shall complete, the assessment without providing any further opportunity of being heard to the assessee, within one month from the end of the month in which such direction is received.

1. *"Dispute Resolution Panel" means a collegium comprising of three Commissioners of Income-tax constituted by the Board for this purpose;*
2. *"Eligible assessee" means*
 - (i) *any person in which case the variation referred to in sub-section (1) arises as a consequence of the order of the Transfer Pricing Officer passed under sub-section (3) of section 93CA; and*
 - (ii) *any foreign company.*

ASSESSMENT IN CASE OF SEARCH OR REQUISITION (SECTION 153A)

Notwithstanding anything contained in sections 139, 147, 148, 149, 151 and 153 in case of a person where search is initiated under section 132 or books of accounts, other documents or any assets are requisitioned under section 132A after 31.05.2003 the Assessing Officer shall assesses or reassesses the total income of six assessment years immediately proceeding the assessment years relevant to the previous year in which such search is conducted or requisition is made.

(A) Notice for filing return [Section 153A(1)(a)]

The Assessing Officer shall issue a notice for furnishing of return of income within the specified period in the notice for six assessment year in the prescribed format.

(B) Separate assessment for six assessment year

The Assessing Officer shall assess or reassess the total income of each of such six assessment year [Proviso 1 to section 153(1)].

(i) Time limit of completion of Assessment of 6 Assessment years [Section 153B(1)(a)]

The Assessing officer shall make an order of assessment or re-assessment in respect of each assessment year falling within six assessment years under section 153A [Assessment in case of search or requisition] within a period of 2 years from the end of the financial year in which the last of the authorization for search under section 132 [search and seizure] or for requisition under section 132A [Powers to requisition books of accounts] was executed.

Where the search was executed on or after 1/4/2009 and during the course of proceedings for the assessment or re-assessment, a reference under section 92CA(1) the period for making an order of assessment or reassessment in respect of each assessment year shall be 3 years instead of 2 years as in normal case above.

(ii) Time limit of completion of assessment year relevant to the previous year in which search is conducted or requisition is made [Section 153(1)(b)]

The Time limit of completion of Assessment in respect of the assessment year 2010-11 & subsequent assessment year relevant to the previous year in which the search is conducted under section 132 or requisition is made under section 132A shall be a period of 3 years w.e.f. 1/7/2012 in case a reference is made under section 92CA(1) to Transfer Pricing officer from the end of the financial year in which the last of the authorization for search under section 132 or for requisition under section 132A, as the case may be was executed.

RECTIFICATION OF MISTAKES [Section 154]

With a view to rectifying any mistakes apparent from the record, an income-tax authority referred to in Section 116 may amend

- any order passed by it under provisions of this Act or
- any intimation or deemed intimation under Section 143(1).

This power of rectification can be exercised by the authorities either on their own motion or at the instance of the assessee.

Mistake which can be rectified

The mistake sought to be rectified may be a mistake of fact or of law. But the mistake must be one which is glaring, obvious or apparent from the records and should not be one to discover which a long drawn process of reasoning, arguments, etc., are needed, or for which there may be conceivably two opinions. A decision on debatable point of law is not a mistake apparent from the record [*T. S. Balram v. Volkart Bros.* (1971) 82 ITR p. 50 (S.C.)]. However, 'the record' contemplated under Section 154 does not mean only the order of assessment but it comprises all proceedings on which the assessment order is based. The relevant authority is entitled to look into the whole evidence and the law applicable to ascertain whether there was an error [*Moharana Mills Pvt. Ltd. v. ITO* (1959) 36 ITR p. 350 (S.C.)].

The power of rectification of mistake lies with the authority who passed the order which is sought to be rectified. For instance, the Assessing Officer may amend any order of assessment or refund or any other order passed by him. Likewise, the Deputy Commissioner or Commissioner (Appeals) or the Chief Commissioner or Commissioner may rectify any order passed by him.

Where an order of rectification of assessment has the effect of enhancing the amount of income assessed or reducing a refund granted to the assessee or in any way otherwise increasing the liability of the assessee, the order of rectification can be passed only after giving the assessee a notice in advance and, that too, after giving him a reasonable opportunity of being heard.

Every order of rectification of assessment must be passed by the authority concerned in writing and should specifically state how and in what respects the assessment had been rectified. Where any amendment has the effect of enhancing the assessment or reducing the refund already made, the Assessing Officer shall serve on the assessee a notice of demand in the prescribed manner specifying the amount of tax, interest or other sum payable by him.

Time limit

The time limit for rectification of mistakes is a period of four years from the end of the financial year in which the order sought to be amended was passed.

where an application for an amendment under this section is made by the assessee on or after the 1st day of June, 2001 to an Income-tax authority referred to in Sub-section (1), the authority shall pass an order, within a period of six months from the end of the month in which the application is received by it:

- by making the amendment; or
- refusing to allow the claim.

LESSON ROUND UP

- The provisions of the Income-tax Act contained in Sections 117 to 136 specify the procedure relating to the appointment of the various income-tax authorities, their powers, functions, jurisdiction and control.
- Income-tax authorities are required to exercise or perform such powers or functions as are assigned to them by the Board [Section 120(1)].
- **Filing of Return:** The procedure under the Income-tax Act for making an assessment of income begins with the filing of a return of income. Section 139 of the Act contains the relevant provisions relating to the furnishing of a return of income.
- **E-Filing of Return:** The Income Tax Department has introduced on line facility in addition to conventional method to file return of income. The process of electronically filing of Income Tax return through the mode of internet access is called e-filing of return.
- **Permanent Account Number:** Every person, who has not been allotted any permanent account number, is obliged to obtain permanent account number, if;
 - if his total income assessable during the previous year exceeds the maximum amount which is not chargeable to tax or
 - any person carrying on business or profession whose total sales turnover or gross receipts are or is likely to exceed ₹5,00,000 in any previous year or
 - is required to furnish a return of income under Section 139.
- **Types Of Assessment**
 - Self assessment (Section 140A)
 - Regular assessment (Section 143)

- Best judgment assessment (Section 144)
- Income escaping assessment or re-assessment (Section 147)
- Precautionary assessment.
- **Self assessment** is the first step in the process of assessments. Self Assessment is simply a process where a person himself assesses his tax liability on the income earned during the particular previous year and submits Income Tax Return to the department.
- **Under summary assessment**, Assessing Officer completes the assessment without passing a regular assessment order. The Assessing Officer issue an acknowledgement/intimation under section 143(1) of tax payable or refundable as the case may be on the basis of Return of Income filed by the assessee under section 139 or in response to a notice issued under section 142(1).
- Where a return has been made under Section 139, or in response to a notice under Sub-section (1) of Section 142, the Assessing Officer shall, if he considers necessary or expedient to ensure that the assessee has not understated the income or has not computed excessive loss or has not underpaid the tax in any manner, serve on the assessee a notice requiring him, on a date to be specified therein, either to attend his office or to produce, or cause to be produced there, any evidence on which the assessee may rely in support of the return.
- **Best Judgment Assessment:** The Assessing Officer, after taking into account all relevant material which he has gathered, and after giving the assessee an opportunity of being heard, makes the assessment of the total income or loss to the best of his judgment and determine the sum payable by the assessee on the basis of such assessment.
- **Income Escaping Assessment:** If the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may, subject to the provisions of sections 148 to 153.
- **Dispute Resolution Panel:** The Assessing Officer shall, forward a draft order of assessment to the eligible assessee if he proposes to make, on or after the 1st day of October, 2009, any variation in the income or loss returned which is prejudicial to the interest of such assessee.
- On receipt of the draft order, the eligible assessee shall, within thirty days of the receipt by him of the draft order.
 - file his acceptance to the Assessing Officer, or
 - file his objections with
 - the Dispute Resolution Panel; and
 - the Assessing Officer
- **Rectification of Mistake:** With a view to rectifying any mistakes apparent from the record, an income-tax authority referred to in Section 116 may amend
 - any order passed by it under provisions of this Act or
 - any intimation or deemed intimation under Section 143(1).

SELF TEST QUESTIONS

These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation.

MULTIPLE CHOICE QUESTIONS

- (1) What is the due date for e-filing if the assessee is a Charitable Trust?
 - (a) 31st of March
 - (b) 30th of September
 - (c) 31st of July
 - (d) 31st of December
- (2) What is the time limit for filing revised return at present?
 - (a) Within the assessment year
 - (b) Before the expiry of one year from the end of the relevant assessment year
 - (c) Before the expiry of two years from the end of the relevant assessment year
 - (d) Before the completion of assessment even if it takes more than one year from the end of the relevant assessment year

ELABORATIVE

1. State the income-tax authorities who are empowered to administer the Income-tax Act and explain their powers, functions and jurisdiction in relation to assessment of income.
2. Discuss the statutory obligations of an assessee to file a return of his income and indicate the time-limits for filing the return.
3. Explain the following :
 - (a) Return of loss; (b) Belated return; (c) Revised return; and (d) Voluntary return.
4. What is self-assessment? What are the consequences of non-payment of tax on "Self-assessment"?
5. Discuss how regular assessments and best judgment assessments are made under the Act?
6. Under what circumstances is the Assessing Officer empowered to reopen the assessment made by him? Give example.
7. Explain the circumstances under which income is said to have escaped assessment and state the power of the Assessing Officer to assess such escaped income. Illustrate.
8. Specify the time limits within which -
 - (a) notice should be issued by the Assessing Officer for making an assessment or re-assessment;
 - (b) the assessment or re-assessment should be completed.
9. What is a mistake apparent from the record? Explain the specific cases of mistakes given in the Act which are to be rectified and state the time limits for rectification in each case.
10. Write a lucid note on best judgment assessment with suitable illustration.

ANSWERS/HINTS

Multiple Choice Question

1. (b) & (c); The due date for the trust shall be 30th September if the income before claiming the exemption u/s 11 & 12 does not exceed the maximum amount not chargeable to tax. However if the charitable trust does not wish to take exemption then its accounts are not required to be audited, the due date shall be 31st July.
2. (b)

SUGGESTED READINGS

1. Dr. V.K. Singhania : Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.
 2. Girish Ahuja and Ravi Gupta : Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.
 3. Dr. V.K. Singhania & Dr. Kapil Singhania : Professional Approach to Direct Taxes Law & Practice; Bharat Law House, New Delhi.
 3. Dr. V.K. Singhania & Dr. Kapil Singhania : Direct Taxes Law & Practice; Taxmann Publications Pvt. Ltd., New Delhi.

Lesson 12

Appeals, Revisions, Settlement of Cases and Penalties & Offences

LESSON OUTLINE

- Introduction
- Appeal Before the Commissioner (Appeals)
 - Procedure for filing of appeal [Section 249(1)]
 - Period of limitation to prefer an appeal [Section 249(2)]
 - Payment of Tax before Filing Appeal [Section 249(4)]
 - Procedure in appeal (Section 250)
- Revision by the Commissioner of Income Tax (Section 263 and 264)
 - Revision of orders prejudicial to the interest of revenue (Section 263)
 - Revision of order in the Interest of Assessee (Section 264)
 - Circumstances in which no revision can be made [Section 264(4)]
- Appeal before Appellate Tribunal
 - Appealable orders [Section 253(1) and (2)]
 - Procedure for filing appeal [Section 253(3), (4)&(6)]
 - Order of Appellate Tribunal (Section 254)
 - Procedure of Appellate Tribunal (Section 255)
- Appeal Before High Court
- Appeal Before Supreme Court
- Settlement of Cases [Sections 245A to 245L]
- Penalties and Offences
- Lesson Round Up
- Self Test Questions

LEARNING OBJECTIVES

Under Income Tax Act, an assessment is normally the first stage for determining the taxable income, tax liability, interest and any other sum payable by an Assessee. The Act provides for various remedies available to an assessee on completion of the assessment. The primary remedies available to an assessee on completion of the assessment are Appeals, Revision, and Rectification. All these remedies work in different areas. However, strictly speaking the remedies are not alternative to each other but at times more than one remedial proceeding may be used as complimentary to each other so as to achieve the best result by applying optimum resources.

The right of appeal arises where the taxpayer is aggrieved by the order passed by the income-tax authority. Where the Assessing Officer accepts the return filed by the tax payer and passes an order making no modification, an appeal does not lie against that order as the taxpayer cannot be said to be aggrieved of that order.

At the end of this lesson, you will learn

- What are the provisions for filing of appeal.
- What is the procedure to file an application before the appellate authority.
- When order of appeal can be revised.
- The provisions to file an application before Settlement Commission.
- What is the ground and quantum of penalty imposed.

Appeal is a complaint to a superior court of an injustice done by an inferior one. The party complaining is termed as the “Appellant” and the other party is known as “Respondent”.

INTRODUCTION

The right of appeal must be given by express enactment in the Act. Therefore, in case there is no provision in the Act for filing an appeal regarding a particular matter, no appeal shall lie. The right of appeal arises where the taxpayer is aggrieved by the order passed by the income-tax authority. Where the Assessing Officer accepts the return filed by the tax payer and passes an order making no modification, an appeal does not lie against that order as the taxpayer cannot be said to be aggrieved of that order. Similarly, where an appellate authority accepts the contention of the taxpayer and allows the appeal, there is no further appeal by the assessee against that order.

The assessee may prefer an appeal against the orders of the Assessing Officer to the Commissioner (Appeals), in accordance with the relevant provisions under Section 246 and appeal against the order of the Commissioner (Appeals) can be preferred by the Assessee or the Commissioner of Income Tax and such appeal lies with the Appellate Tribunal.

The Finance (No.2) Act, 1998 has amended the provisions regarding remedy against order of Tribunal. Where earlier the assessee or the CIT, if not satisfied with the order of Tribunal, could only request the Tribunal to refer that matter to the High Court. After 1.10.98 as provided by Finance (No.2) Act, 1998 the assessee or CIT if not satisfied with the order of the tribunal can appeal directly to the High Court, if High Court is satisfied that the case involve a substantial question of law and if the assessee or Commissioner of Income-tax is not satisfied with the order passed by the High Court they may file an appeal against the order of the High Court to the Supreme Court. However, it should be noted that in the case of question of fact tribunal is the final & binding authority and its decision is final.

APPEALABLE ORDERS BEFORE COMMISSIONER (APPEALS) (SECTION 246A)

Any assessee or any deductor aggrieved by any of the following orders may appeal to the Commissioner (Appeals):

- (a) against an order passed by a Joint Commissioner under Clause (ii) of Sub-section (3) of Section 115VP or an order against the assessee where he denies his liability to be assessed under the Income Tax Act, or an intimation under section 143 (1) or (1B) or section 200A(1) where the assessee or deductor objects to making of adjustment or any order of assessment under section 143(3) except an order passed in pursuance of directions of Dispute Resolution Panel or Section 144 where assessee object to the amount of income assessed or amount of tax determined or amount of loss computed or status under which he is assessed;
- (aa) an order of assessment under Sections 115WE or 115WF where the assessee being an employer objects to the value of fringe benefits assessed;
- (b) against an order of assessment, re-assessment or re-computation under Section 147 except an order passed in pursuance of directions of dispute resolution panel or Section 150;
- (ba) an order of assessment or reassessment under Section 153A except an order passed in pursuance of directions of dispute resolution panel;
- (bb) an order of assessment or re-assessment under section 92CD(3);
- (c) against an order of rectification of mistake under Section 154 or Section 155 having effect of enhancing assessment or reducing refund or order refusing to allow claim made by assessee under these sections;
- (d) against an order under Section 163 treating the assessee as the agent of a non-resident;
- (e) against an order under Section 170(2) or 170(3) relating to succession of business otherwise on death;

- (f) against an order made under Section 171;
- (g) against an order under Section 185;
- (h) against an order cancelling the registration of firm under section 186(1) or (2);
- (i) against an order under Section 237;
- (j) against an order under Section 201 or 206 (C)(A);
- (k) A person deemed to be an assessee in default for not collecting the whole or any part of tax or after collecting the tax, failing to pay the same, may appeal before Commissioner (Appeals) on or after April 1, 2007.
- (l) against an order imposing a penalty under Section 221, 271, 271A, 271AAA, 271AAB, 271F, 271FB, 272AA, Section 272, 272B, 272BB or Section 273;
- (m) an order of imposing or enhancing penalty under Section 275(1A);
- (n) against an order of assessment made by an assessing officer under clause (c) of Section 158BC, in respect of search initiated under Section 132 or books of account, other documents or any assets requisitioned under Section 132A;
- (o) against an order imposing a penalty under Sub-section (2) of Section 158BFA;
- (p) against an order imposing penalty under Section 271B or Section 271BB;
- (q) against an order made by a Joint Commissioner imposing a penalty under Section 271C, Section 271CA, Section 271D or Section 271E;
- (r) against an order made by a Joint Commissioner imposing a penalty under Section 272AA and by a Joint Commissioner or Joint Director under Section 279A;
- (s) against an order imposing a penalty under Chapter XXI of Income tax Act;
- (t) against an order made by an Assessing Officer other than a Joint Commissioner under the provisions of this Act, in case of specified person or classes of persons.

Where a person has deducted and paid tax in accordance with Section 195 and 200 in respect of any sum (other than interest) chargeable under the Act he is entitled to prefer an appeal under Section 248 to be declared not liable to deduct tax. In other words, the right to appeal under Section 248 is conditional and can be exercised only if tax is deducted at source and paid to the Government.

Section 248 has been substituted with effect from June 1, 2007. The modified version provides that where under an agreement or other arrangement, the tax deductible on any income (not being interest) under Section 195 is to be borne by the payer (i.e., "net of tax" arrangement) and such person having paid such tax to the credit of the Central Government, claims that no tax was required to be deducted on such income, he may appeal to the Commissioner (Appeals) for a declaration that no tax was deductible on such income.

PROCEDURE FOR FILING OF APPEAL [SECTION 249(1)]

The appeal should be filed in the prescribed form and verified in the prescribed manner. In case of an appeal made to the Commissioner (Appeals) on or after the 1st day of October, 1998, it shall be accompanied by a fees irrespective of the date of initiation of the assessment proceedings. The rates of fees are as follows:

- ₹250 when the assessed income is one hundred thousand rupees or less (income/loss) compute.
- ₹ 500 when the assessed income is more than one hundred thousand rupees but not more than two hundred thousand rupees.

- ₹1000 when the assessed income is more than two hundred thousand rupees.
- ₹250 in any other case.

Form No. 35 is the prescribed form [under Rule 45(1)] of the appeal. The form of appeal, the grounds and the verification appended to the form should be signed [Rule 45(2)] as per provisions applicable to the signing of return under Section 140.

Form No.35 requires that the memorandum of appeal, statement of facts and the grounds of the appeal must be in duplicate and should be accompanied by a copy of the order appealed against and the notice of demand in original, if any.

PERIOD OF LIMITATION TO PREFER AN APPEAL [SECTION 249(2)]

The appeal has to be presented within the period of limitation as given below:

1. *Appeal by person denying liability to deduct tax in respect of payments payable to non-resident or a foreign company [Section 249(2)(a)]*: Where the appeal relates to any tax deducted at source from payment made to a non-resident, (other than a company) or to a foreign company, any interest, other 'than interest on securities or any other sum chargeable under the provisions of the Income Tax Act (not being salaries), within 30 days from the date of payment of tax deducted at source to the credit of the Central Government.
2. *Appeal against assessment to penalty [Section 249(2)(b)]*: Where the appeal relates to any assessment or penalty order the appeals have to be presented within 30 days of the date of service of the notice of demand relating to that assessment or penalty order.
3. *Other appeals [Section 249(2)(c)]*: In any other case, the appeal has to be presented within 30 days of the date on which intimation of the order sought to be appealed against is served on the appellant.

In computing the period of limitation for an appeal or an application, the day on which the order is served has to be excluded. If the assessee was not furnished with a copy of the order along with the notice of the order, or demand, the time required for obtaining a copy of such order is also to be excluded and the date will be extended by that period. It may be noted that even where the assessee has not been supplied with copy of the order concerned, the time taken in making an application which does not comply with all the legal requirements cannot be excluded under the provisions of Section 268. If the application for obtaining the copy of the order has not been properly stamped or has been made by a person not authorised to do so, the time which has elapsed between the making of the invalid application and putting the application in order would not be excluded in computing the period of limitation.

If any appeal is filed after the period of limitation, the Commissioner (Appeals) may admit the appeal after the said period if he is satisfied that the appellant had sufficient cause for not presenting the appeal within that period [Section 249(3)]. Such delayed appeals must be accompanied by a condonation petition showing and explaining the reason/cause of the appellant for not being able to file the appeal within the period of limitation and praying for condemnation of the delay. The power to condone the delay is discretionary and the discretion must be judiciously exercised. The discretion is to be exercised where sufficient cause for not presenting the appeal within the time is made out by the appellant. The period for filing an appeal cannot be extended simply because the appellant's case is hard and calls for sympathy or merely out of benevolence to the party seeking relief. The sufficient cause must be a cause which is beyond the control of the party seeking the condonation of the delay. Illness is sufficient cause, if it can be shown that the man was utterly disabled to attend to any duty. The cause for delay in filing the appeal which, by due care and attention could have been avoided cannot be a sufficient cause. Negligence on the part of the servants or agent entrusted with the filing of the appeal cannot be considered as a sufficient cause. The change of legal situation brought about by a decision of the Supreme Court may be valid ground for condoning delay. The words "sufficient cause" should receive a liberal interpretation so as to advance substantial justice where no negligence nor inaction nor want of bona fide is imputable to the applicant.

An appeal presented after the period of limitation is still an “appeal” and an order dismissing it as time barred is one passed in appeal [under Section 250 and not under Section 249(3)]. An appeal lies therefrom to the Appellate Tribunal and thereafter to the High Court on a question of law.

PAYMENT OF TAX BEFORE FILING APPEAL [SECTION 249(4)]

No appeal against any order passed by the Assessing Officer can be admitted by the Commissioner (Appeals) unless at the time of filing of the appeal the assessee has paid tax due on the income returned by him, and where the assessee has not furnished the return of income, he has paid an amount equal to the amount of advance tax which was payable by him. If the appellant wants exemption from the payment of such tax he has to make an application to the Commissioner (Appeals) who is empowered to waive this requirement in appropriate cases if he is satisfied that there are good and sufficient reasons for doing so. In such cases, the Commissioner (Appeals) is required to record such reasons in writing. It may be noted that Income-tax law requires only the payment of tax before the filing of the appeal and not the payment of any penalty or any other sum payable by the assessee on the basis of the order appealed against.

PROCEDURE IN APPEAL (SECTION 250)

Commissioner (Appeals) shall fix a day and place for the hearing of the appeal and shall give notice of the same to the appellant and to the Assessing Officer against whose order the appeal is preferred.

The following shall have the right to be heard at the hearing of the appeal:

- (a) The appellant, either in person or by an authorised representative.
- (b) The Assessing Officer, either in person or by a representative.

The Commissioner (Appeals) shall have the power to adjourn the hearing of the appeals from time to time. He may, before disposing of any appeal, make such further enquiry as he deems fit, or may direct the Assessing Officer to make further enquiry and report as he deems fit, or may direct the Assessing Officer to make further enquiry and report the result of the same to the Commissioner (Appeals).

The Commissioner (Appeals) may, at the hearing of an appeal, allow the appellant to go into any ground of appeal not specified in the grounds of appeal if he is satisfied that the omission of that ground from the form of appeal was not willful or unreasonable. His order disposing of the appeal shall be in writing and shall state the points for determination, the decision thereon and the reasons for the decision. In every appeal, the Commissioner (Appeal), where it is possible, may hear and decide such appeal within a period of one year from the end of the financial year in which such appeal is filed before him Commissioner (Appeal) under Section 246A(1). On the disposal of the appeal, the Commissioner (Appeals) shall communicate the order passed by him to the assessee and to the Chief Commissioner or Commissioner.

POWERS OF THE COMMISSIONER (APPEALS) (SECTION 251)

In disposing of an appeal, the Commissioner (Appeals) shall have the following powers:

1. In an appeal against an order of assessment, he may confirm, reduce, enhance or annul the assessment.
2. In an appeal against an order imposing a penalty, he may confirm or cancel such order or vary it so as to either enhance or reduce the penalty.
3. In any other case, he may pass such orders in the appeal as he deems fit.

The Commissioner (Appeals) shall not enhance an assessment or a penalty or reduce the amount of refund unless the appellant has had a reasonable opportunity of showing cause against such enhancement or reduction.

While disposing an appeal, the Commissioner (Appeals) may consider and decide the facts arising out of the proceedings which in respect of order appealed against were carried notwithstanding that such matter was not raised before the Commissioner (Appeals) by the appellant.

From the Assessment year 2009-10, in an appeal against the order of assessment in respect of which the proceedings before the Settlement Commission abates under the section 245HA, the Commissioner (appeals) can confirm, reduce, enhance or annul the assessment after taking into consideration of the following –

1. the material and other information produced by the assessee before the Settlement Commission
2. the results of the enquiry held by the Settlement Commission
3. the evidence recorded by the Settlement commission in the course of proceedings before it
4. such other material as may be brought on his record.

REVISION BY THE COMMISSIONER OF INCOME TAX (SECTIONS 263 AND 264)

The right to file such appeals against the orders of the Assessing Officer is not available to the Department. It is for this reason that the Commissioner has been vested with revisional powers under Section 263, where the order of the Assessing Officer is erroneous in so far as it is prejudicial to the interests of the revenue. But such revisional power can be exercised only in respect of orders which are not the subject matter of appeals. The reason is that once an assessment order is appealed against, the Commissioner (Appeals) has got the powers to enhance the assessment under Section 263 and a right of appeal upto the Tribunal is provided to the assessee against the orders of the Assessing Officer. In the following cases Commissioner of Income-tax can revise an order passed by the Assessing Officer:

REVISION OF ORDERS PREJUDICIAL TO THE INTEREST OF REVENUE (SECTION 263)

The Department has no right of appeal to the Commissioner (Appeals) against any order passed by the Assessing Officer. Therefore, the Commissioner of Income-tax has been empowered to revise such orders of the Assessing Officer as are prejudicial to the interest of the revenue. Such power, however, is subject to certain conditions as given below :

1. Revision can be only of the order of Assessing Officer [Section 263(1)]

The Commissioner of Income-tax can revise only the orders of Assessing Officer. For the purposes of this clause, an order passed by the Assessing Officer includes an order of assessment passed on or before or after 1.6.1988, including: (i) an assessment order made by the Assistant Commissioner or the Income Tax Officer on the basis of the directions issued by the Joint Commissioner under Section 144A, (ii) an order made by the Joint Commissioner in exercise of the powers or in performance of the functions of an Assessing Officer conferred on, or assigned to him under the orders or directions issued by the Board or by the Chief Commissioner or Director General or Commissioner authorised by the Board in this behalf under Section 120 [Jurisdiction of Income Tax authorities].

In case the order referred to above has been the subject matter of any appeal filed on or before or after June1, 1988 the powers of the Commissioner shall extend and shall always be deemed to have extended to such matters as had not been considered and decided in such appeal. The appellate orders passed by the Commissioner (Appeals) are outside the purview of the revisional powers vested in the Commissioner of Income-tax. But if the assessment order of the Assessing Officer is pending in an appeal before the appellate authority (as aforesaid), it can be revised by the Commissioner of Income-tax. So long the appeal is not disposed of, the order of the Assessing Officer will be considered as subsisting and operative. Therefore, it can be revised.

2. Order erroneous and prejudicial to the interest of revenue [Section 263(1)]

If the Commissioner of Income-tax considers that the order of the Assessing Officer is erroneous in so far as it is prejudicial to the interest of the revenue, such order can be revised after giving the assessee an opportunity of being heard.

The word “erroneous” includes cases where there has been a failure to make the necessary enquiries. The Commissioner of Income-tax may consider an order of the Assessing Officer to be erroneous not only if it contains some apparent error of reasoning or of law or of fact on the face of it but also because it is a stereotype order which

simply accepts what the assessee has stated in his return and fails to make enquiries which are called for in the circumstances of the case. The Assessing Officer is not only an adjudicator but also an investigator. He cannot remain passive in the face of a return which is apparently in order but calls for further enquiry. It is his duty to ascertain the truth of the facts stated in return when the circumstances of the case are such as to provoke enquiry.

The words "prejudicial to the interests of revenue" appearing under Section 263(1) have not been defined in the Act, but they must mean that the order of the Assessing Officer is such, that it is not in accordance with law in consequence whereof the lawful revenue due to the State has not been realised or cannot be realised. The Allahabad High Courts' decision in *Commissioner of Income-tax v. Sunder Lal* (1974, 96 ITR 310) was followed by it in *Commissioner of Income-tax v. Kashi Nath & Co.* 1988, 170 ITR 28) holding that the power of the Commissioner of income-tax under Section 263 of the Income Tax Act is quasi-judicial in character. He must give reasons in support of his conclusion that the assessment order is erroneous in so far as it is prejudicial to the interests of the Revenue. If he does not give the reasons, the order can be vitiated. For example, if the Commissioner is of the opinion that the Assessing Officer had allowed deductions in excess of what they were due in a particular case, such order is erroneous and prejudicial to the interests of the revenue. Hence, it may be revised by the Commissioner of Income Tax.

In *Malabar Industrial Co. Ltd. v. Commissioner Income Tax* (1992, 198 ITR 611) the Kerala High Court held that the words 'prejudicial to the interests of the revenue' are of wide import and they should not be limited to a case where the order passed by the Income-tax Officer (now Assessing Officer) can be considered to be one prejudicial to the revenue administration as such. The question whether an order of the Income Tax Officer is prejudicial to the interests of revenue would depend on the facts of each case and there can be no universal formula applicable to finding out any such prejudicial error. The High Court followed the rule laid down by the Supreme Court in *Tara Devi Aggarwal v. CIT* (1973, 88 ITR 523) but dissented from the rule laid down by the Madras High Court in *Venkatakrishna Rice Co. v. CIT* (1987, 163 ITR 129).

The Commissioner can revise an order passed by the Assessing Officer only if it is erroneous and prejudicial to the interests of the revenue; if the order sought to be revised is not prejudicial to the interest of the revenue the Commissioner has no jurisdiction to revise it. The failure of the Assessing Officer to deal with the claim of the assessee in the assessment order may be an error, but an erroneous order by itself is not enough to give jurisdiction to the Commissioner to revise it under Section 263. It must be further shown that the order was prejudicial to the interests of the revenue.

3. Assessee to be given an opportunity of being heard [Section 263(1)]

The process of revision is completed in three stages: (i) the Commissioner may call for and examine the records of any proceeding under the Act which is within his administrative powers. If after examining the material and relevant facts on record, the Commissioner considers *prima facie* that any order of the Assessing Officer is erroneous and prejudicial to the interest of the revenue, he must, in the (ii) place, give the assessee an opportunity of being heard. The opportunity of being heard to be given to the assessee contemplates that the Commissioner must disclose to the assessee the grounds on which he desires to make a revision under Section 263. This is essential. If the assessee does not know on what points he is to be heard, he may not visualise what he has to say at the hearing and the opportunity of being heard may prove to be illusory. Further, the notice to show cause must be served on the assessee reasonably ahead of the date fixed for hearing, because the time allowed to the assessee to prepare the case should not be short but reasonable. The Commissioner is also required to examine the merits of the objection raised by the assessee. Without going into the merits of the claim of the assessee, it is not possible for the Commissioner to say that the order of the Assessing Officer has caused any prejudice to the interests of the revenue. He may also cause enquiry to be made by his subordinates. Before making his order, he must disclose to the assessee the material collected by him on enquiry if he wants to use the materials collected from such inquiry against the assessee. If the matter collected from the enquiry is only supporting material and does not constitute the basic grounds on which the revision order is to be passed, the failure of the Commissioner to disclose to the assessee the fact of the enquiry does not vitiate the revision order.

In the third stage, the Commissioner is required to pass the necessary order if he finally concludes that the order of the Assessing Officer is erroneous and prejudicial to the interests of the revenue. He can enhance or modify the assessment. He has also the power to cancel the assessment and direct a fresh assessment. The power of cancellation of the assessment with a direction to make a fresh assessment is called for only in cases where there is something totally or basically wrong with the assessment which is not capable of being remedied by amendments to the assessment order itself. Where the Commissioner comes to the conclusion that there is a defect in the assessment order in so far as the question of the levy of interest was not considered by the Assessing Officer, the Commissioner should direct the Assessing Officer to consider the question on merits and in accordance with law after giving the assessee an opportunity of being heard. It is not further necessary for him, nor would the circumstances of the case justify, that the whole assessment should be set aside. Setting aside the assessment has got far reaching consequences and such power should be exercised only where the circumstances call for a remedial action. The revisional order must be a speaking order giving reasons for such revisions otherwise the order may be vitiated. The power of suo-moto revision of the Commissioner of Income-tax under Section 263(1) is in the nature of supervisory jurisdiction and can be exercised only if the circumstances specified therein exist. Two circumstances must exist: (i) the order should be erroneous, and (ii) by virtue of the order being erroneous, prejudice must have been caused to the interests of the revenue. An order cannot be termed as erroneous unless it is not in accordance with law. If an Income-tax Officer acting in accordance with law makes certain assessment, the same cannot be termed as erroneous by the Commissioner simply because according to him, the order should have been written more elaborately. In this case, the Tribunal was held justified in setting aside the order passed by the Commissioner under Section 263.

4. Time limit for making the revisional order [Sections 263(2) and (3)]

The revisional order can be passed within two years from the end of the financial year in which the order sought to be revised was passed [Section 263(2)]. Once the revisional order is made within the time limit of two years from the end of the relevant financial year it is a valid order even if it is served on the assessee after the expiry of two years.

In computing the time limit of two years, the time taken in giving an opportunity to the assessee to be reheard (under Section 129) and any period during which the proceeding (under Section 263) is stayed by an order or injunction of any court is excluded [Explanation to Section 263(2)]. Order under Section 263 can't be passed to reduce tax utility or in favour of assessee. However Appeal against Section 263 can be made to ITAT.

It may be noted that the limit of two years does not apply to a revisional order which had been passed in consequences of or to give effect to, any finding or direction contained in an order of the Appellate Tribunal, the High Court or the Supreme Court. Such revisional order may be passed at any time [Section 263(3)].

REVISION OF ORDER IN THE INTEREST OF ASSESSEE (SECTION 264)

An aggrieved assessee has his normal right of appeal against the order of the Assessing Officer to Commissioner (Appeals) under Section 246A and thereafter to the Appellate Tribunal under Section 253. Further, each and every order of the Assessing Officer is not appealable to the appellate authorities under Sections 246A and 253. The assessee may seek justice in such cases by making an application under section 264 to the Commissioner of Income Tax. For example, revision lies to the Commissioner against the levy of penal interest for not furnishing the return of total income within the prescribed time against which no appeal has been provided.

The revisional order passed under Section 264 cannot be prejudicial to the interest of the assessee. The whole subject matter is discussed below –

1. Revision of order of subordinate authority only [Section 264(1) and Explanation 2]

The Commissioner of Income Tax may revise any order of an authority subordinate to him. Deputy Commissioner, Income Tax Officers and Inspectors of Income Tax are subordinate to the Commissioner according to Section 118.

2. *Suo motu revision [Section 264(1) and (2)]*

The Commissioner may, suo motu call for the record of any proceeding under this Act in which any, order has been passed by any authority subordinate to him. He may make such enquiry and may pass such order as he thinks fit but such order cannot be prejudicial to the assessee [Section 264(1)]. He may act in such circumstances without notice to the assessee and without giving him an opportunity of being heard. Such exercise of the authority is a purely departmental affair and the assessee may know nothing about this. While acting suo motu, the Commissioner may revise the order of his subordinate authority within one year from the date of the order sought to be revised [Section 264(2)]. If the order has been made more than one year back, such order cannot be revised by him.

It is obligatory on the Commissioner w.e.f. October 1, 1998 to pass an order under Section 264 within a period of one year from the end of financial year in which the application is made for revision. In computing the period of limitation, the time taken in giving an opportunity to the assessee to be re-heard (under Section 129) and any period during which any proceeding under this Section is stayed by an order or injunction of any court is excluded. Though an order has, to be passed within one year, an order in revision may be passed at any time in consequence of or to give effect to any findings or directions contained in an order of the Appellate Tribunal, High Court or the Supreme Court.

3. *Revision on application of the assessee [Section 264(1), (3) & (5)]*

The assessee is entitled to make an application to the Commissioner of Income-tax for the revision of any order passed by an authority subordinate to him. Such an application can be made within one year from the date on which the order in question was communicated to him or from the date on which he otherwise came to know of it, whichever is earlier [Section 264(3)]. The Commissioner is empowered to admit a belated application if he is satisfied that the assessee was prevented by sufficient cause from making the application within the prescribed time.

The application for revision by the assessee is always to be accompanied by a fee of ₹500 [Section 264(5)]. On receipt of the revision application, the Commissioner may call for the record. He may make such enquiry and pass such order as he deems fit. Such an order should not be prejudicial to the assessee [Section 264(1)].

There are two important points of distinction between the cases: (i) where the Commissioner makes suo motu revision; and (ii) where he makes a revision on the application of the assessee. While acting suo motu, he can pass the revisional order only within one year from the date of the order sought to be revised. There is no such time limit when the revisional order is passed on the basis of application filed by the assessee. Once the application is made within the period of limitation prescribed therefor, or after the condonation of delay, the order may be passed at any time thereafter. Secondly, while acting suo motu, the Commissioner acts in the exercise of his administrative jurisdiction and, hence, he is not bound to give a hearing to the assessee. In fact the review is purely a departmental affair in such cases. On the other hand, when he is moved by the assessee for the said purposes, the jurisdiction conferred on him is a judicial one and, hence, he must give an opportunity to the assessee to put forward his case.

4. *Nature of the order under Section 264*

The Commissioner may pass such order as he thinks fit provided such order is not prejudicial to the assessee. This is so whether the Commissioner acts suo motu, or on the revision application of the assessee. An order of the Commissioner passed in revision can be said to be prejudicial to the assessee only when he is, as a result of it, placed in a different and worse position than that in which he was placed by the order under review'. If the Commissioner effects a reduction of income under one head and an increase under another but, on the whole reduces the assessment, his order cannot be said to be prejudicial to the assessee. Though the Commissioner may not change the order of the subordinate authority to the prejudice of the assessee, he may not give the relief asked for by the assessee. An order of the Commissioner declining to interfere with the order of the

subordinate authority cannot be deemed to be an order prejudicial to the assessee (Explanation 1 to Section 264). The power to pass such orders as he deems fit is not an arbitrary one to be exercised according to his fancy. He must act according to the rules of reason and justice, not according to private opinion, according to law not humor. His discretion is not to be arbitrary, vague and fanciful, but legal and regular. It is a power coupled with duty to exercise it in the interest of justice to the assessee.

CIRCUMSTANCES IN WHICH NO REVISION CAN BE MADE [SECTION 264(4)]

The Commissioner of Income-tax cannot revise the order of his subordinate authority in the following cases:

- (i) If the order is appealable to the Commissioner (Appeals), such order cannot be revised until the time within which such appeal may be made expires. If an appeal has been made to the Commissioner (Appeals), the revisional power cannot be exercised while the appeal is pending but it may be exercised after the appeal has been disposed of. The Commissioner (Appeals) for the purpose of Section 264 is an authority subordinate to the Commissioner of Income-tax. Hence, the order of the Commissioner (Appeals) can be revised.
- (ii) If the order is appealable to the Commissioner (Appeals) or the Appellate Tribunal, revisional power cannot be exercised until the time within which such appeal may be made expires. But, in such cases, if the assessee waives his right of appeal, the Commissioner may revise the order even before the time for appeal has expired. But once the order has been made the subject of an appeal the revisional powers come to an end. An order can be said to be made the "subject of an appeal" only when it is the subject of an effective appeal. If the Commissioner (Appeals) or the Appellate Tribunal refuses to entertain an appeal on the ground that it is time barred, or grants permission to the appellant to withdraw the appeal, the order cannot be said to be the "subject of an appeal" and the assessee would be entitled to apply to the Commissioner for revision.

REMEDY AGAINST THE REVISIONAL ORDER

An order of the Commissioner passed under Section 264 is not appealable to the Tribunal. Nor does a reference lie against such an order to the High Court since a reference to the High Court lies only against an order passed by the Tribunal. Since the order of the Commissioner is judicial or quasi-judicial in character, it is within the ambit of the High Court's jurisdiction under Article 226 of the Constitution and a petition for a writ of certiorari to quash an unjust or illegal order of the Commissioner is maintainable.

APPELLATE TRIBUNAL (SECTION 252)

The Central Government shall constitute an Appellate Tribunal consisting of as many judicial and accountant members as it thinks fit to exercise the powers and discharge the functions conferred on the Appellate Tribunal by this Act. The ITAT is constituted and works under the Ministry of Law. It is thus a body outside the administrative control of the Central Board of Direct Taxes.

The Appellate Tribunal is not an Income-tax Authority in the sense of being an integral part of the department. On the contrary, by its constitution, powers and jurisdiction, not to speak of the manner of their recruitment, the Tribunal is an independent arbitral tribunal. The proceedings before it are advisory. It has also the trappings of a judicial body in the sense that it has to deal with the Department on the one side, and the assessee on the other in as much as they face each other as opposing parties. In such a situation the Tribunal has to decide only those issues which are properly raised before it by the one or the other party in the appeal or in the cross objections. Under the Act, the Tribunal has got to decide an appeal and not merely give it a disposal by dismissing it for default of appearance. This, however, does not mean that the Tribunal has got to take upon themselves the responsibility of finding facts or points of law which are not urged by the Department or the assessee, as the case may be. *CIT v. A. C. Paul (1983) 142 ITA 811 (Mad.)*

The Tribunal is the final Authority and ordinarily, if after considering the matters in the proper perspective and after surveying all material which is available to it, the Tribunal arrives at some conclusion one way or the other, that conclusion would have to be respected, unless it can be regarded as impossible or perverse. *C/ITv. Lalchand Bhabutmal Jain (1985) 151 ITR 360 (Bom.)*.

APPEALABLE ORDERS [SECTION 253(1) AND (2)]

Any assessee aggrieved by any of the following orders may appeal to the Appellate Tribunal against such order.

1. An order passed by Commissioner (Appeals) under Section 154 ordering a rectification of mistake, or under Section 250 in connection with the disposal of an appeal or Section 271 imposing a penalty for failure to furnish return etc. or Sections 271 A or 272A.
2. An order passed by an assessing officer under Clause (c) of Section 158BC, in respect of search initiated under Section 132 or books of account other documents or any assets requisitioned under Section 132A, after the 30th day of June, 1995 but before the 1st day of January, 1997.
3. An order passed by a Commissioner under Section 12AA relating to registration of trust or under Section 263 relating to revision of orders prejudicial to revenue or under Section 272A penalty for failure to answer question, sign statements, allow inspection etc., on or under Section 154 rectifying a mistake, or an order passed by a Chief Commissioner, or a Director General or a director under Section 272A.
4. An order passed by an Assessing Officer under Sub-section (1) of Section 115VZC.
5. An order passed by a Commissioner for rejection of approval under Section 80G(5)(vi).
6. An order passed by an Assessing Officer under section 143(3) or section 147 or section 153A or section 153C with the approval of the commissioner or an order passed under section 154 or section 155.

The Commissioner may, if he objects to any order passed by Commissioner (Appeals) under Section 154 or 250, direct the Assessing Officer to appeal to the Appellate Tribunal against the order.

PROCEDURE FOR FILING APPEAL [SECTION 253(3), (4)&(6)]

Every appeal to the Appellate Tribunal shall be filed within sixty days of the date on which the, order sought to be appealed against is communicated to the assessee or to the Commissioner, as the case may be.

The Assessing Officer or the assessee, as the case may be, on receipt of notice that an appeal against the order of the Commissioner (Appeals) has been preferred by the other party may, notwithstanding that he may not have appealed against such order or any part thereof, within thirty days of the receipt of notice, file a memorandum of cross-objections, verified in the prescribed manner, against any part of the order of the Commissioner (Appeals) and such memorandum shall be disposed of by the Appellate Tribunal as if it were an appeal presented within the specified period.

The Appellate Tribunal may admit an appeal or permit the filing of a memorandum of cross-objections after the expiry of the relevant period if it is satisfied that there was sufficient cause for not presenting it within that period.

An appeal to the Appellate Tribunal shall be in the prescribed form and shall be verified in the prescribed manner and shall, in case of an appeal made on or after the 1st day of October, 1998, irrespective of the date of initiation of the assessment proceedings be accompanied by a fine of :

- (a) ₹ 500 where the assessed income/loss is 1,00,000 rupees or less.
- (b) ₹ 1,500 where the assessed income/loss is more than one hundred thousand rupees but not more than two hundred thousand rupees.

- (c) One percent of the assessed income, subject to a maximum of ten thousand rupees where the assessed income is more than two hundred thousand rupees,
- (d) ₹ 500 in any other case, except in case of an appeal filed by the department or a memorandum of cross-objections.

An application for stay of demand has to be accompanied by a fee of ₹ 500.

In making an appeal to the Tribunal, the following documents shall be sent in triplicate.

- (a) The memorandum of appeal.
- (b) The grounds of appeal.
- (c) Copy of the order of the Commissioner (Appeals).
- (d) Copy of the grounds of appeal and statement of facts filed before the Commissioner (Appeals).
- (e) Copy of the order of the Assessing Officer.
- (f) Challan for payment of requisite fee.

Where the appellant desires to refer to any documents or evidence he is permitted to file the same with Tribunal in the form of a paper book within one month from the date of filing the appeal. Though the prescribed period in one month, it will be preferable to file the same along with the appeal. Where an appellate order by the Commissioner (Appeals) is passed as a consolidated order for a number of years, appeals to the Tribunal shall be filed separately for each year.

ORDER OF APPELLATE TRIBUNAL (SECTION 254)

The Appellate Tribunal may, after giving both the parties to appeal an opportunity of being heard, pass such orders thereon as it may think fit.

The Appellate Tribunal may, at any time within four years from the date of the order, with a view to rectifying any mistake apparent from the record, amend any order passed by it and shall make such amendment if the mistake is brought to its notice by the assessee or the Assessing Officer. But, any amendment which has the effect of enhancing an assessment or reducing a refund or otherwise increasing the liability of the assessee shall not be made unless the Appellate Tribunal has given notice to the assessee of its intention to do so and has allowed the assessee a reasonable opportunity of being heard.

The Tribunal's decision would have binding effect within the jurisdiction and has a persuasive value outside its jurisdiction.

Sub-sections (2A) and (2B) have been inserted by Finance Act, 1999 w.e.f. 1.6.99. Sub-section (2A) provides that in every appeal, the Appellate Tribunal, where it is possible may hear and decide such appeal within a period of four years from the end of the financial year in which such appeal is filed under Section 253(1). Sub-section (2B) provides that the cost of any appeal to the Appellate Tribunal shall be at the discretion of the Tribunal.

Section 254(2A) pertaining to stay of demand by the Appellate Tribunal has been modified as follows:

1. Initially the Tribunal can pass an order of the stay only for a period not exceeding 180 days from the date of the order staying the demand.
2. The tribunal shall dispose of appeal within the aforesaid period.
3. If appeal is not disposed of within the aforesaid period, the period of stay may be extended. The total period of stay cannot be more than 365 days reckoned from the beginning of the period. Extension is possible only if delay is not attributable to assessee.

4. Appeal shall be disposed of by the Tribunal within the extended period.
5. If appeal is not disposed of within the extended period or periods, the order of stay shall stand vacated after the expiry of such period or periods.

The Appellate Tribunal shall send a copy of any orders passed under this section to the assessee and to the Commissioner. On question of fact, the order passed by the Appellate Tribunal on appeal shall be final. An order made by the Appellate Tribunal shall be sufficiently comprehensive and self-contained. It should be possible to ascertain from the order all the relevant facts and the questions arising on the appeal. It should also disclose what were the contentions of the parties and should state why and for what reasons those contentions were repelled.

Under Section 254(1), the Tribunal may, after giving both parties to the appeal an opportunity of being heard, pass such-orders thereon as it deems fit.

No limitation has been placed on the powers of the Commissioner (Appeals) or the Appellate Tribunal under Section 251(1) or 254(1). The only limitation on their appellate jurisdiction is that they cannot go into the question of propriety of an ex-parte proceeding or a best judgement assessment. The quantum of assessment, the quantum of tax or the question of registration of a firm can always be gone into. *Vishnu Kumar Gupta v. CIT (1983) 143 ITR 169 (All)*. However, the power of stay is not likely to be exercised in a routine way or as a matter of course in view of the special nature of taxation and revenue laws. Only when a strong *prima facie* case is made out, the Tribunal will consider whether to stay the recovery proceedings. Stay will be granted only in deserving and appropriate cases and where the Tribunal is satisfied that the entire purpose of the appeal will be frustrated or rendered nugatory by allowing the recovery proceedings to continue during the dependency of the appeal before it.

Section 254(1) empowers the Appellate Tribunal to give its decision on the grounds urged and it can pass appropriate orders. It is not open to the Tribunal itself to raise a ground or permit the party who had not appealed to raise a ground which will work adversely on the appellants.

Under Section 254(2), the Appellate Tribunal has got ample power to rectify a mistake apparent from record *suo motu*. If the mistake is brought to the notice of the Tribunal by the parties to the appeal, the Tribunal is empowered to rectify the same. *Addl. CIT v. ITAT (1983) 139 ITR 615 (AP)*.

From the Assessment year 2009-10(w.e.f.1.10.2008),the third proviso to sub-section (2A) provides that if such appeal is not decided within the period allowed originally or the periods so extended or allowed ,the order of stay shall stand vacated after expiry of such period or periods.

The intention behind these provisions has been very clear that the Appellate tribunal cannot grant stay either under the original order or any other subsequent order, beyond the period of 365 days in aggregate.

If the Tribunal is unable to decide the appeal on the basis of materials before it, it may admit fresh evidence and decide the appeal. It may also keep the appeal pending and direct any one of the subordinate authorities to ascertain further facts.

PROCEDURE OF APPELLATE TRIBUNAL (SECTION 255)

The powers and functions of the Appellate Tribunal may be exercised and discharged by benches constituted by the President of the Appellate Tribunal from amongst the members thereof. The bench shall consist of one judicial member and one accountant member.

The President or any other member of the Appellate Tribunal, authorised in this behalf by the Central Government, may, sitting singly, dispose of any case which has been allotted to the Bench of which he is a member and which pertains to an assessee whose, total income as computed by the Assessing Officer in the case does not exceed ₹5,00,000. The President may, for the disposal of any particular case, constitute a Special Bench consisting of

three or more members, one of whom shall necessarily be a judicial member and one an accountant member.

If the members of a Bench differ in opinion on any point, the point shall be decided according to the opinion of the majority if there is a majority. But if the members are equally divided, they shall state the point or points on which they differ and the case shall be referred by the President of the Appellate Tribunal for hearing on such point or points by one or more of the other members of the Appellate Tribunal. Such point or points shall be decided according to the opinion of the majority of the members of the Appellate Tribunal who have heard the case including those who first heard it.

The Appellate Tribunal shall have the power to regulate its own procedure and the procedure of Benches thereof in all matters arising out of the exercise of its powers or of the discharge of its functions including the places at which the Benches shall hold their sittings.

The Appellate Tribunal shall have, for the purpose of discharging its functions, all the powers which are vested in the Income-tax authorities under Section 131, and any proceeding before the Appellate Tribunal shall be deemed to be a judicial proceeding and for the purpose of Section 196 of the Indian Penal Code, the Appellate Tribunal shall be deemed to be a Civil Court for all purposes of Section 195 and Chapter XXXV of the Code of Criminal Procedure.

The Appellate Tribunal is a final fact finding authority and if it arrives at its own conclusions or facts after the consideration of the evidence before it, the Court will not interfere. It is necessary, however, that every fact 'for' and 'against' the assessee must have been considered with due care and the Tribunal must have given its finding in a manner which would have clearly indicated what were the questions which arose for determination, what was the evidence pro and contra in regard to each one of them, and what were the findings reached on the evidence on record before it.

APPEAL TO HIGH COURT

Sections 260A and 260B are inserted w.e.f. October 1, 1998. Section 260A provides that an appeal shall lie to the High Court from every order passed in appeal by the Appellate Tribunal if the High Court is satisfied that the case involves a substantial question of law.

The Chief Commissioner or the Commissioner or an assessee aggrieved by any order passed by the Appellate Tribunal may file an appeal to the High Court and such appeal shall be filed within 120 days of the date on which the order appealed against is received by the assessee or the Chief Commissioner or Commissioner and shall be filed in the form of memorandum of appeal precisely stating the substantial question of law involved.

If the High Court is satisfied that a substantial question of law is involved in any case, it shall formulate that question. The appeal shall be heard only on the question so formulated, and the respondents shall at the hearing of the appeal, be allowed to argue that the case does not involve such question. However, the High Court may for reasons to be recorded, hear the appeal on any other substantial question of law not formulated by it, if it is satisfied that the case involves such question.

The High Court shall decide the question of law so formulated and deliver such judgment thereon containing the grounds on which such decision is founded and may award such cost as it deems fit.

The High Court may determine any issue which has not been determined by the Appellate Tribunal or has been wrongly determined by the Appellate Tribunal on such substantial question of law.

Where the High Court delivers a judgement in an appeal filed before it under Section 260A, effect shall be given to the order passed on the appeal by the Assessing Officer on the basis of a certified copy of judgement [Section 260(1A)].

Section 260B provides that an appeal filed under Section 260A shall be heard by a bench of not less than two judges of the High Court and shall be decided in accordance with the opinion such Judges or the majority, if any.

Where, however, there is no such majority, the part of law upon which they differ shall be referred to one or more of the Judges of the High Court and shall be decided according to the opinion of the majority of the Judges who have heard the case including those who first heard it.

The High Court also has power to stay a proceeding for recovery of demand arising out of the assessment order pending disposal of appeal.

APPEAL TO THE SUPREME COURT (SECTION 261)

The aggrieved party is entitled to appeal to the Supreme Court against the judgment delivered by the High Court on the reference application made to it by the Tribunal (under Section 256) against an order made under Section 254 before the 1st day of October, 1998 or an appeal made to High Court in respect of an order passed under Section 254 on or after that date provided the High Court certifies the case to be fit for appeal to the Supreme Court. The right of appeal is, therefore, conditional and may be availed of only if the High Court gives a certificate of such fitness.

The High Court could certify the case as a fit one for appeal and grant leave to the Supreme Court if a substantial question of law is involved or if the question is likely to come up in successive year or if the question is otherwise of great public or private importance.

An application of fitness for appeal to the Supreme Court has to be made within 60 days from the date of High Court's judgment (under Article 132 of the Schedule to the Limitation Act, 1963). The time required for taking a certified copy of the High Court's judgment is to be excluded in computing such period of limitation.

If the High Court refuses to certify a case to be fit for appeal to the Supreme Court, an application may be made to the Supreme Court (under Article 136 of the Constitution) for special leave to appeal against the decision of the High Court.

The provisions of the Code of Civil Procedure, 1908 relating to the appeal to the Supreme Court are applicable in the case of appeals under Section 261 in the same manner as they are applicable in the case of appeals from decrees of a High Court [Section 262(1)].

Where the judgment of the High Court is changed or reversed in the appeal, effect is given to the order of the Supreme Court [Section 262(3)]. The law declared by the Supreme Court is binding on all courts within the territory of India under Article 141 of the Constitution.

On the receipt of a copy of judgment, the Appellate Tribunal has to pass such orders as are necessary to dispose of the case conformably to such judgment.

To award the cost of an appeal is at the discretion the Supreme Court

[Section 262(2)]. It would be open to the Court not to award costs even to the party which has succeeded in the appeal before it. If the Supreme Court awards costs to a party and the party has not complied with the order, a petition may be made to the appropriate High Court for execution of the order of the Supreme Court (Section 266). The High Court may transmit the order for execution to any court subordinate to it (Section 266).

Section 257 enables the Appellate Tribunal to make a direct reference to the Supreme Court if the Tribunal is of the opinion that, on account of a conflict in the decision of High Court in respect of any particular question of law, it is expedient that a reference should be made directly to the highest court.

SETTLEMENT OF CASES [Sections 245A to 245L]

Chapter XIXA provides for settlement of the cases which may be pending before an Income-tax authority. Further an appeal to the Appellate Tribunal by the assessee, and which is pending before it, may be withdrawn by the assessee with the permission of the tribunal, to have his case settled under Sections 245A to 245L. Accordingly the Central Government constituted an Income-tax Settlement Commission consisting of a chairman

and as many Vice- Chairman and other members as considered appropriate by the Central Government from amongst persons of integrity and outstanding ability, having special knowledge of, and, experience in problems relating to direct taxes and business accounts. However, in the event of a member of the CBDT having been appointed as the Chairman, Vice-Chairman or member of the Commission, he shall cease to be a member of the Board.

MEANING OF THE TERMS 'CASE' [Section 245A(b)]

"case" means any proceeding for assessment under this Act, of any person in respect of any assessment year or assessment years, which may be pending before an Assessing Officer on the date on which an application under Section 245C(1) is made.

Proceeding of assessment for which an application can not be made to the Settlement commission :

In the following cases though the proceeding is pending before the assessing officer, the assessee shall not be allowed to make the application to the Settlement Commission;

- (a) A proceeding for assessment or reassessment under section 147 and such proceeding shall be deemed to be commenced from the date on which a notice under section 148 is issued.
- (b) A proceeding for assessment or reassessment for any of the six assessment years referred to in section 153A(b) in case of a person referred in section 153A or section 153C. These proceeding shall be deemed to be commenced from the date of initiation of the search under section 132 or requisition under section 132A (omitted by Finance Act,2010 w.e.f 01/06/2010).
- (c) A proceeding for assessment or reassessment for any of the six assessment years referred to in section 153B(1)(b) in case of a person referred in section 153A or section 153C. Such proceeding shall be deemed to be commenced from the date of initiation of the search under section 132 or requisition under section 132A (omitted by Finance Act,2010 w.e.f 01/06/2010).

It is now proposed by Finance Act, 2010) to include proceedings for assessment or reassessment resulting from search or as a result of requisition of books of account or other documents or any assets, within the definition of a "case" which can be admitted by the Settlement Commission.

The date on which the proceedings for assessment or reassessment shall be deemed to have commenced on the date of issue of notice initiating such proceedings and concluded on the date on which assessment is made.(inserted by Finance Act, 2010).

- . (d) A proceeding for making fresh assessment in pursuance of an order under section 254 or section 263 or section 264, setting aside or cancelling an assessment. Such proceeding shall be deemed to be commenced from the date on which the order under section 254,263 or 264, setting aside or cancelling an assessment was passed.

JURISDICTION AND POWERS OF SETTLEMENT COMMISSION [Section 245BA]

Subject to the other provisions of this Chapter, the jurisdiction, powers and authority of the Settlement Commission may be exercised by Benches thereof.

Subject to the other provisions of this section, a Bench shall be presided over by the Chairman or a Vice-Chairman and shall consist of two other Members.

The Bench for which the Chairman is the Presiding Officer shall be the principal Bench and the other Benches shall be known as additional Benches.

When one of the persons constituting a Bench (whether such person be the Presiding Officer or other Member of the Bench) is unable to discharge his functions owing to absence, illness or any other cause or in the event of the occurrence of any vacancy either in the office of the Presiding Officer or in the office of one or the other

Members of the Bench, the remaining two persons may function as the Bench and if the Presiding Officer of the Bench is not one of the remaining two persons, the senior among the remaining persons shall act as the Presiding Officer of the Bench :

The Chairman may, for the disposal of any particular case, constitute a Special Bench consisting of more than three Members.]

The places at which the principal Bench and the additional Benches shall ordinarily sit shall be such as the Central Government may, by notification in the Official Gazette, specify and the Special Bench shall sit at a place to be fixed by the Chairman

APPLICATION FOR SETTLEMENT OF CASES [Section 245C]

An assessee may, at any stage of a case relating to him, make an application in the prescribed Form (Form No.34B) alongwith the prescribed fee to the Settlement Commission to settle the case. Such an application once made cannot be withdrawn by the applicant.

The assessee's application has to be made:

- in such form and in such manner as may be prescribed and
- containing full and true disclosure of his income, which has not been disclosed before the Assessing Officer,
- the manner in which such income has been derived,
- the additional amount of income-tax payable on such income and
- such other particulars as may be prescribed.

Such application can be made to the settlement commission only;

1. where the additional amount of income- tax payable on the income disclosed in the application exceeds 3 lac rupees; and
2. such tax and interest thereon, which would have been paid under the provisions of this Act, had the income disclosed in the application been declared in the return of income before the assessing officer on the date of the application, has been paid on or before the date of making the application and proof of such payment is attached with the application.

The following paragraph shall be applicable from 01-06-2010 in place of the above mention (1) & (2):

1. In a case where proceedings for assessment or reassessment have been initiated as a result of search or as a result of requisition of books of account or other documents or any assets, if the additional amount of income-tax payable on the income disclosed in the application exceeds fifty lakh rupees. (Inserted by Finance Act,2010 w.e f 01-06-2010)
2. In any other case, if the additional amount of income-tax payable on the income disclosed in the application exceeds ten lakh rupees. (Inserted by Finance Act,2010 w.e f 01-06-2010).

Such tax and interest thereon shall be paid before making an application and the proof of such payment is attached with the application.

The additional Income-tax mentioned above shall be the amount calculated in accordance with the following points:

- I. When income disclosed in the application relates only to one previous year -
 - A. (i) if the applicant has not furnished a return in respect of the total income of that year (whether or not an assessment has been made in respect of the total income of that year), then, except

where the proceeding pending before the income-tax authority is in the nature of a proceeding for assessment or reassessment, tax shall be calculated on the income disclosed in the application as if such income were the total income;

- (ii) if the applicant has furnished a return in respect of the total income of that year (whether or not an assessment has been made in pursuance of such return), tax shall be calculated on the aggregate of the total income returned and the income disclosed in the application as if such aggregate were the total income;
 - (iii) if the proceeding pending before the Income-tax authority is in the nature of a proceeding for reassessment of the applicant under Section 147 or by way of appeal or revision in connection with such re-assessment, and the applicant has not furnished a return in respect of the total income of that year in the course of such proceeding for re-assessment, tax shall be calculated on the aggregate of the total income as assessed in the earlier proceeding for assessment under Section 143 or 144 or 147 and the income disclosed in the application as if such aggregate were the total income.
- B. The additional amount of income-tax payable in respect of the income disclosed in the application relating to the previous year referred to in Sub-section (1B) shall be,
- (a) in a case referred to at (i) hereinabove, the amount of tax calculated under that clause;
 - (b) in a case referred to at (ii) hereinabove, the amount of tax calculated on the total income returned for that year;
 - (c) In a case referred to at (iii) hereinabove, the amount of tax calculated thereunder in the earlier proceeding for assessment under Sections 143, 144 or 147;

II. Where income disclosed in the application relates to more than one previous year, the income-tax shall be calculated in the above manner for each of the years separately and then aggregated and that will be the actual amount payable.

III. Where any books of accounts and unexplained valuables are seized under Section 132, the Assessee can make the application for settlement only after 120 days of the seizure.

PROCEDURE ON RECEIPT OF AN APPLICATION UNDER SECTION 245C [Section 245D]

(1) On receipt of an application under section 245C, the Settlement Commission shall, within seven days from the date of receipt of the application, issue a notice to the applicant requiring him to explain as to why the application made by him be allowed to be proceeded with, and on hearing the applicant, the Settlement Commission shall, within a period of fourteen days from the date of the application, by an order in writing, reject the application or allow the application.

Provided that where no order has been passed within the aforesaid period by the Settlement Commission, the application shall be deemed to have been allowed.

(2) A copy of every order under sub-section (1) shall be sent to the applicant and to the Commissioner.

(2A) Where an application was made under section 245C before the 1st day of June, 2007, but an order under the provisions of sub-section (1) of this section, as they stood immediately before their amendment by the Finance Act, 2007, has not been made before the 1st day of June, 2007, such application shall be deemed to have been allowed to be proceeded with if the additional tax on the income disclosed in such application and the interest thereon is paid on or before the 31st day of July, 2007.

Explanation. In respect of the applications referred to in this sub-section, the 31st day of July, 2007 shall be deemed to be the date of the order of rejection or allowing the application to be proceeded with under sub-section (1).

(2B) The Settlement Commission shall,

- (i) in respect of an application which is allowed to be proceeded with under sub-section (1), within thirty days from the date on which the application was made; or
- (ii) in respect of an application referred to in sub-section (2A) which is deemed to have been allowed to be proceeded with under that sub-section, on or before the 7th day of August, 2007, call for a report from the Commissioner, and the Commissioner shall furnish the report within a period of thirty days of the receipt of communication from the Settlement Commission.

(2C) Where a report of the Commissioner called for under sub-section (2B) has been furnished within the period specified therein, the Settlement Commission may, on the basis of the report and within a period of fifteen days of the receipt of the report, by an order in writing, declare the application in question as invalid, and shall send the copy of such order to the applicant and the Commissioner:

Provided that an application shall not be declared invalid unless an opportunity has been given to the applicant of being heard:

Provided further that where the Commissioner has not furnished the report within the aforesaid period, the Settlement Commission shall proceed further in the matter without the report of the Commissioner.

(2D) Where an application was made under sub-section (1) of section 245C before the 1st day of June, 2007 and an order under the provisions of sub-section (1) of this section, as they stood immediately before their amendment by the Finance Act, 2007, allowing the application to have been proceeded with, has been passed before the 1st day of June, 2007, but an order under the provisions of sub-section (4), as they stood immediately before their amendment by the Finance Act, 2007, was not passed before the 1st day of June, 2007, such application shall not be allowed to be further proceeded with unless the additional tax on the income disclosed in such application and the interest thereon, is, notwithstanding any extension of time already granted by the Settlement Commission, paid on or before the 31st day of July, 2007.]

(3) The Settlement Commission, in respect of

- (i) an application which has not been declared invalid under sub-section (2C); or
- (ii) an application referred to in sub-section (2D) which has been allowed to be further proceeded with under that sub-section,

may call for the records from the Commissioner and after examination of such records, if the Settlement Commission is of the opinion that any further enquiry or investigation in the matter is necessary, it may direct the Commissioner to make or cause to be made such further enquiry or investigation and furnish a report on the matters covered by the application and any other matter relating to the case, and the Commissioner shall furnish the report within a period of ninety days of the receipt of communication from the Settlement Commission:

Provided that where the Commissioner does not furnish the report within the aforesaid period, the Settlement Commission may proceed to pass an order under sub-section (4) without such report.

(4) After examination of the records and the report of the Commissioner, if any, received under

- (i) sub-section (2B) or sub-section (3), or
- (ii) the provisions of sub-section (1) as they stood immediately before their amendment by the Finance Act, 2007,

and after giving an opportunity to the applicant and to the Commissioner to be heard, either in person or through a representative duly authorised in this behalf, and after examining such further evidence as may be placed before it or obtained by it, the Settlement Commission may, in accordance with the provisions of this Act, pass such order as it thinks fit on the matters covered by the application and any other matter relating to the case not covered by the application, but referred to in the report of the Commissioner.

(4A) The Settlement Commission shall pass an order under sub-section (4),

- (i) in respect of an application referred to in sub-section (2A) or sub-section (2D), on or before the 31st day of March, 2008;
- (ii) in respect of an application made on or after the 1st day of June, 2007 but before 1st day of June, 2010, (inserted by Finance Act, 2010) within twelve months from the end of the month in which the application was made.
- (iii) in respect of an application made on or after the 1st day of June, 2010, within eighteen months from the end of the month in which the application was made (inserted by Finance Act, 2010).

(5) Subject to the provisions of section 245BA, the materials brought on record before the Settlement Commission shall be considered by the Members of the concerned Bench before passing any order under sub-section (4) and, in relation to the passing of such order, the provisions of section 245BD shall apply.

(6) Every order passed under sub-section (4) shall provide for the terms of settlement including any demand by way of tax, penalty or interest, the manner in which any sum due under the settlement shall be paid and all other matters to make the settlement effective and shall also provide that the settlement shall be void if it is subsequently found by the Settlement Commission that it has been obtained by fraud or misrepresentation of facts.

(6A) Where any tax payable in pursuance of an order under sub-section (4) is not paid by the assessee within thirty-five days of the receipt of a copy of the order by him, then, whether or not the Settlement Commission has extended the time for payment of such tax or has allowed payment thereof by instalments, the assessee shall be liable to pay simple interest at one and one-fourth per cent for every month or part of a month on the amount remaining unpaid from the date of expiry of the period of thirty-five days aforesaid.]

(7) Where a settlement becomes void as provided under sub-section (6), the proceedings with respect to the matters covered by the settlement shall be deemed to have been revived from the stage at which the application was allowed to be proceeded with by the Settlement Commission and the income-tax authority concerned, may, notwithstanding anything contained in any other provision of this Act, complete such proceedings at any time before the expiry of two years from the end of the financial year in which the settlement became void.

(8) For the removal of doubts, it is hereby declared that nothing contained in section 153 shall apply to any order passed under sub-section (4) or to any order of assessment, reassessment or recomputation required to be made by the Assessing Officer in pursuance of any directions contained in such order passed by the Settlement Commission and nothing contained in the proviso to sub-section (1) of section 186 shall apply to the cancellation of the registration of a firm required to be made in pursuance of any such directions as aforesaid.

POWER OF SETTLEMENT COMMISSION

Power of Settlement Commission to Order Provisional Attachment to Protect Revenue (Section 245DD)

(1) During the pendency of any proceeding before the settlement commission, it (the settlement commission) can attach provisionally any property belonging to the applicant in the manner provided in the second schedule if it is of the opinion that it is necessary to do so for protecting the interests of the revenue.

Provided that where, a provisional attachment made under Section 281B is pending immediately before an application is made under Section 245C, an order under this sub-section shall continue such provisional attachment upto the period upto which an order made under Section 281B would have continued if such application had not been made.

Further provided that where the Settlement Commission passes an order under this sub-section after the expiry of the period referred to in the preceding proviso, the provisions of Sub-section (2) shall apply to such order as if the said order had originally been passed by the Settlement Commission.

(2) Every provisional attachment made by the Settlement Commission under Sub-section (1) shall cease to have effect after the expiry of a period of six months from the date of the order made under Sub-section (1):

Provided that the Settlement Commission may, for reasons to be recorded in writing extend the aforesaid period by such further period or periods as it thinks fit, so, however, that the total period of extension shall not in any case exceed two years.

Power of Settlement Commission to Re-Open Completed Proceedings (Section 245E)

If the Settlement Commission is of the opinion (the reasons for such opinion to be recorded by it in writing) that for the proper disposal of the case pending before it, it is necessary or expedient to re-open any proceeding connected with the case but which has been completed under this Act by any income-tax authority before the application under Section 245C was made, it may, with the concurrence of the applicant, re-open such proceeding and pass such order thereon as it thinks fit as if the case in relation to which the application for settlement had been made by the applicant under that section covered such proceeding also.

But no proceeding shall be re-opened by the Settlement Commission under this section if the period between the end of the assessment year to which such a proceeding relates and the date of application for settlement under Section 245C exceeds nine years.

And no proceeding shall be reopened by the Settlement Commission under this section in a case where an application is made on or after 1st day of June 2007.

Powers and Procedure of Settlement Commission (Section 245F)

- (1) In addition to the powers conferred on the Settlement Commission under this Chapter, it shall have all the powers which are vested in an income-tax authority under this Act.
- (2) Where an application made under Section 245C has been allowed to be proceeded with under Section 245D, the Settlement Commission shall, until an order is passed under Sub-section (4) of Section 245D, have subject to the provisions of Sub-section (3) of that section, exclusive jurisdiction to exercise the powers and perform the functions of an income-tax authority under this Act in relation to the case.
- (3) Notwithstanding anything contained in Sub-section (2) and in the absence of any express direction to the contrary by the Settlement Commission, nothing contained in this section shall affect the operation of any other provision of this Act requiring the applicant to pay tax on the basis of self-assessment in relation to the matters before the Settlement Commission.
- (4) For the removal of doubts, it is declared that, in the absence of any express direction by the Settlement Commission to the contrary, nothing in chapter XIX-A shall affect the operation of the provisions of this Act in so far as they relate to any matters other than those before the Settlement Commission.
- (5) The Settlement Commission shall, subject to the provisions of Chapter XIX-A have power to regulate its own procedure and the procedure of Benches thereof in all matters arising out of the exercise of its powers or of the discharge of its functions, including the places at which the Benches shall hold their sittings.

Inspection, etc., of Reports (Section 245G)

No person shall be entitled to inspect, or obtain copies of, any reports made by any income-tax authority to the Settlement Commission; but the Settlement Commission may, in its discretion, furnish copies thereof to any such person on an application made to it in this behalf and on payment of the prescribed fee which is 80 paise for the first two hundred words or less and 40 paise for every additional hundred words or less.

Provided that, for the purpose of enabling any person whose case is under consideration to rebut any evidence brought on record against him in any such report, the Settlement Commission shall, on an application made in this behalf, and on payment of the prescribed fee by such person, furnish him with a certified copy of any such report or part thereof relevant for the purpose.

Power of Settlement Commission to Grant Immunity from Prosecution and Penalty [Section 245H(1)]

The Settlement Commission may, if it is satisfied that any person who made the application for Settlement under Section 245C has co-operated with the Settlement Commission in the proceedings before it, and has made a full and true disclosure of his income and the manner in which such income has been derived, grant to such person, subject to such conditions as it may think fit to impose, immunity from prosecution for any offence under this Act or under the Indian Penal Code (45 of 1860) or under any other Central Act for the time being in force and also (either wholly or in part) from the imposition of any penalty under this Act, with respect to the case covered by the Settlement. Provided that no such immunity shall be granted by the Settlement Commission in cases where the proceedings for the prosecution for any such offence have been instituted before the date of receipt of the application under Section 245C.

(1A): An immunity granted to a person under Sub-section (1) shall stand withdrawn if such person fails to pay any sum specified in the order of settlement passed under Sub-section (4) of Section 245D within the time specified in such order or within such further time as may be allowed by the Settlement Commission, or fails to comply with any other condition subject to which the immunity was granted and thereupon the provisions of this Act shall apply as if such immunity had not been granted.

(2) An immunity granted to a person under Sub-section (1) may, at any time, be withdrawn by the Settlement Commission, if it is satisfied that such person had, in the course of settlement proceedings, concealed any particulars material to the settlement or had given false evidence, and thereupon such person may be tried for the offence with respect to which the immunity was granted or for any other offence of which he appear to have been guilty in connection with the settlement and shall also become liable to the imposition of any penalty under this Act to which such person would have been liable, had not such immunity been granted.

Power of Settlement Commission to send a Case Back to the Assessing Officer if the Assessee does not Co-Operate (Section 245HA)

- (1) The Settlement Commission may, if it is of the opinion that any person who made an application for settlement under Section 245C has not co-operated with the Settlement Commission in the proceedings before it, send the case back to the Assessing Officer who shall thereupon dispose of the case in accordance with the provisions of this Act as if no application under Section 245C had been made.
- (2) For the purposes of Sub-section (1), the Assessing Officer shall be entitled to use all the materials and other information produced by the Assessee before the Settlement Commission or the results of the inquiry held or evidence recorded by the Settlement Commission in the course of the proceedings before it as if such materials, information, inquiry and evidence had been produced before the Assessing Officer or held or recorded by him in the course of the proceedings before him.
- (3) For the purposes of the time-limit under Sections 149, 153, 154, 155 and 231 and for the purpose of payment of interest under Sections 243 and 244, in a case referred to in Sub-section (1), the period commencing on and from the date of the application to the Settlement Commission under Section 245C and ending with the date of receipt by the Assessing Officer of the order of the Settlement Commission sending the case back to the Assessing Officer shall be excluded; and where the assessee is a firm, for the purposes of the time limit for cancellation of registration of the firm under Sub-section (1) of Section 186, the period aforesaid shall, likewise, be excluded.

Order of Settlement to be Conclusive (Section 245-I)

Every order of settlement passed under Sub-section (4) of Section 245D shall be conclusive as to the matters stated therein and no matter covered by such order shall, save as otherwise provided in this chapter, be re-opened in any proceeding under this Act or under any other law for the time being in force.

Recovery of Sums Due Under Order of Settlement (Section 245-J)

Any sum specified in an order of settlement under Sub-section (4) of Section 245D may, subject to such conditions, if any, as may be specified therein, be recovered, and any penalty for default in making payment of such sum may be imposed and recovered in accordance with the provisions of Chapter XVII, by the Assessing Officer having jurisdiction over the person who made the application for Settlement under Section 245C.

Bar on Subsequent Application for Settlement in Certain Cases (Section 245-K)

Where,

- (i) an order of settlement passed under Sub-section (4) of Section 245D provides for the imposition of a penalty on the person who made the application under Section 245C for settlement, on the ground of concealment of particulars of his income; or
- (ii) after the passing of an order of settlement under the said Sub-section (4) in relation to a case, such person is convicted of any offence under Chapter XXII in relation to that case; or
- (iii) the case of such person is sent back to the Assessing Officer by the Settlement Commission under Section 245HA,

then, he shall not be entitled to apply for settlement under Section 245C in relation to any other matter.

Proceedings before Settlement Commission to be Judicial Proceedings (Section 245-L)

Any proceeding under this Chapter before the Settlement Commission shall be deemed to be a judicial proceeding within the meaning of Sections 193 and 228, and for the purposes of Section 196 of the Indian Penal Code (45 of 1860).

DEFAULTS AND PENALTIES

An assessee should note that compliance with legal formalities is less costly than the payment of penalties or interest on tax dues. There are several formalities to be complied with to avoid any penalty. In this connection, reference may be made to the following table summarizing the defaults and penalties therefor.

Chapters XVII and XXI of Income-tax Act, 1961, contain various provisions empowering an Income-tax Authority to levy penalty in case of certain defaults. The various types of penalties are briefly described in the table given below:

Section	Type of Default	Quantum of Penalty		Levied by (Authority)
		Minimum Penalty	Maximum Penalty	
1	2	3	4	5
140A(3)	Failure to pay the self assessment tax or interest or part thereof or both under Section 140A(1)	Such amount as the Assessing Officer may impose	Tax in arrears	Assessing Officer
158BFA	Determination of undisclosed income of block period	Minimum 100% of tax leviable in respect of undisclosed income	Maximum 300% of tax leviable in respect of undisclosed income	Assessing Officer or Commissioner (Appeals)
221(1)	Failure to make payment of tax and interest payable under	Such amount as the Assessing Officer may	Tax in arrears	- do-

	Section 220(2) within the prescribed time limit	impose		
271(1)(b)	Failure to comply with: (i) a notice under Sections 115WD(2); 115WE; 142(1); 143(2) or, (ii) a direction under Section 142(2A)	₹ 10,000 per failure	₹ 10,000 per failure	Assessing Officer
271(1)(c)	Concealment of the particulars of income or furnishing of inaccurate particulars of income	100% of tax sought to be evaded	300% of the amount of tax sought to be evaded	Assessing Officer or Commissioner (Appeals)
271(1)(d)	Concealment of particulars of Fringe Benefit	-do-	-do-	-do-
271(4)	Distribution of profit by registered firm otherwise than in accordance with partnership deed and as a result of which partner has returned income below the real income	Upto 150% of difference between tax on partner's income assessed and tax on returned income in addition to tax payable	—	-do-
271A	Failure to keep, maintain or retain books of account etc. as required under Section 44AA	₹ 25,000	₹ 25,000	Assessing Officer or Commissioner (Appeals)
271AA	Failure to keep and maintain information and document in respect of international transaction or specified domestic transaction or fails to report such transactions or maintains or furnishes an incorrect information or document .	—	A sum equal to 2% of the value of each inter-national transaction or specified domestic transaction.	-do-
271B	Failure to get accounts audited under Section 44AB or furnish audit report along with return of income	One-half per cent of Total Sales, turnover	₹1,50,000	Assessing Officer
271BA	Failure to furnish report under Section 92E	₹ 1,00,000	—	-do-
271BB	Failure to subscribe to eligible issue of capital	20% of amount to be subscribed		
271C	Failure to deduct tax at source or failure to pay wholly or partly the tax u/s 115-O(2) or second proviso to Section 194-B	A sum equal to the amount of tax omitted to be deducted or paid	—	-do-
271CA	Failure to collect tax at source	100% of tax sought to be collected	—	Imposed by the Joint Commissioner
271D	Taking any loan or deposit in contravention of Section 269SS.	A sum equal to the amount of loan or deposit so taken or accepted	—	-do-
271E	Repayment of deposit in contravention of Section 269T.	A sum equal to the amount of deposit	—	-do-

271F	Failure to furnish returns as required by Section 139(1) and the proviso to Section 139(1) on or before due date	—	₹ 5,000	—
271FA	Failure to Furnish Annual Information Return in Section 285BA(2)	₹ 100 per day during which such failure continues	—	—
	Failure to Furnish Annual Information Return in Section 285BA(5)	₹ 100 per day during the failure continues begining immediately after the expiry of time periodspecified in the notice of furnishing return	—	—
271FB	Failure to furnish Fringe Benefit Return	₹ 100 per day for the days of default	—	—
271G	Failure to furnish information or document in respect of international transaction or specified domestic transaction under Section 92D(3).	A sum equal to 2% of the value of each international transaction or specified domestic transaction.	—	Assessing Officer or Commissioner (Appeals)
271H	Fails to furnish statement within the time prescribed in sub-section (3) of section 200 or proviso to section 206C(3) or furnishes incorrect information. However, no penalty shall be payable if tax along with interest has been deposited and the statement has been furnished within one year from the time prescribed.	₹10,000	₹ 1,00,000	—
272A (1)(a)	Failure to answer any question put to person legally bound to state the truth of any matter touching the subject of his assessment by an income-tax authority.	—	₹10,000 for each default	Joint Director or Joint Commissioner
272A (1)(b)	Failure to sign any statement made by a person in course of income-tax proceeding	—	₹ 10,000 for each default	-do-
272A (1)(c)	Failure in compliance with — summons issued under Section 131(1) to attend office to give evidence and produce books of accounts or other documents	₹ 10,000 for each default		Joint Director or Joint Commissioner
272A(2)	Failure to comply with a notice issued under Section 94, to give notice of disconti-nuance of business/ profession under Section 176(3); fails to furnish returns/ statements specified in	—	₹ 100 for every day of default	Joint Director or Joint Commissioner (Chief Commissioner or Commissioner in

Sections 133, 206, 206C, or 285B; fails to allow inspection of (i) register mentioned in Section 134, or (ii) entry in such register, or (iii) allow copies thereof to be taken, fails to furnish return of income under Section 139(4A) or, fails to deliver declaration under Section 197A; fails to furnish certificate under Section 203 or section 206C, fails to deduct and pay tax under Section 226; fails to deduct or pay tax u/s 192(2C), fails to deliver a copy of declaration u/s 206C(1A); fails to deliver the copy of statement within the time specified u/s 200(3) or the proviso to 206C(3); fails to deliver within the time specified u/s 206A(1).

However, no penalty shall be payable where statement required u/s 200(3) or proviso to section 206C(3) on or after 1st July 2012.

case of default under Section 197A)

272AA	Failure in compliance with Section 133B	Any amount subject to ₹ 1,000 a maximum of ₹ 1,000	Joint Commissioner/ Asstt Director/ Assessing Officer
272B	Failure to comply with Section 139A (PAN)	₹ 10,000	—
272BB	Failure in compliance with Section 230A	—	₹ 10,000
272BBB	Failure to comply with Section 206CA (TCAN)	₹ 10,000	—

LESSON ROUND UP

- The right to appeal must be given by express enactment in the Act. Therefore, in case there is no provision in the Act for filing an appeal regarding a particular matter, no appeal shall lie. The right to appeal arises where the taxpayer is aggrieved by the order passed by the income-tax authority.
- The assessee may prefer an appeal against the orders of the Assessing Officer to the Commissioner (Appeals), in accordance with the relevant provisions under Section 246 and appeal against the order of the Commissioner (Appeals) can be preferred by the Assessee or the Commissioner of Income Tax and such appeal lies with the Appellate Tribunal.
- The Central Government shall constitute an Appellate Tribunal consisting of as many judicial and accountant members as it thinks fit to exercise the powers and discharge the functions conferred on the Appellate Tribunal by this Act.

- Section 260A provides that an appeal shall lie to the High Court from every order passed in appeal by the Appellate Tribunal if the High Court is satisfied that the case involves a substantial question of law.
- The aggrieved party is entitled to appeal to the Supreme Court against the judgment delivered by the High Court.
- Chapter XIXA provides for settlement of the cases which may be pending before an Income-tax authority. Further an appeal to the Appellate Tribunal by the assessee, and which is pending before it, may be withdrawn by the assessee with the permission of the tribunal, to have his case settled under Sections 245A to 245L.
- “Case” means any proceeding for assessment under this Act, of any person in respect of any assessment year or assessment years, which may be pending before an Assessing Officer on the date on which an application under Section 245C(1) is made.
- An assessee may, at any stage of a case relating to him, make an application in the prescribed Form (Form No.34B) along with the prescribed fee to the Settlement Commission to settle the case.
- Chapters XVII and XXI of Income-tax Act, 1961, contain various provisions empowering an Income-tax Authority to levy penalty in case of certain defaults.

SELF TEST QUESTIONS

These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation.

1. Explain the provisions with respect to appeals and revisions with reference to tax planning.
2. Explain the provisions relating to revision of assessment order prejudicial to the interest of assessee.
3. What are the various grounds of appeals available before different types of authorities to the assessee?
4. Under what circumstances the assessment order can be revised on the basis of applications of the assessee? Under what circumstances the revision cannot be made ?
5. Under what circumstances can an assessee appeal to the Appellate Tribunal? What documents are to be attached in mailing an appeal to the Tribunal?
6. When can an aggrieved party appeal to the Supreme Court against the judgment delivered by the High Court?
7. Compliance with legal formalities is less costly than the payment of penalty or interest due on taxes. Explain the statement briefing the defaults and penalties under the Income-tax Act.

SUGGESTED READINGS

1. Dr. V.K. Singhania : Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.
2. Girish Ahuja and Ravi Gupta : Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.
Professional Approach to Direct Taxes Law & Practice; Bharat Law House, New Delhi.
3. Dr. V.K. Singhania & Dr. Kapil Singhania : Direct Taxes Law & Practice; Taxmann Publications Pvt. Ltd., New Delhi.

Lesson 13

Tax Planning & Tax Management

LESSON OUTLINE

- Concept of Tax Planning
- Right To Plan Tax Liability
- Tax Planning, Tax Evasion And Tax Avoidance
- Objectives of Tax Planning
- Importance of Tax Planning
- Essentials of Tax Planning
- Types of Tax Planning
- Areas of Tax Planning in the Context of Income Tax Act, 1961
 - Form of organization/ownership pattern
 - Locational Aspects
 - Nature of business
 - Tax planning in respect of corporate restructuring
 - Tax planning in respect of financial management
 - Tax planning in respect of employees remunerations
 - Tax planning in respect of specific managerial decisions
 - Tax planning in respect of Non-Residents
- Planning in the Context of Court Rulings and Legislative Amendments
- Statutory Force of the Notifications
- Organisation of tax planning cells
- Overall tax planning measures
- Some general considerations regarding new business
- Setting up and commencement of business vis a vis tax planning
- Lesson Round Up
- Self Test Questions

LEARNING OBJECTIVES

Tax Planning is an exercise undertaken to minimize tax liability through the best use of all available allowances, deductions, exclusions, exemptions, etc., to reduce income and/or capital gains. While tax management involves compliance of law regularly and timely as well as the arrangement of the affairs of the business in such manner that it reduces the tax liability. The functions under tax management includes filing of return, payment of tax on time, appear before the appellate authority etc. and all these have been discussed in previous lesson. Here in this lesson we will analyze constituents of tax planning, tax evasion, tax avoidance, etc.

At the end of this lesson, you will learn

- What is tax planning, tax avoidance and tax evasion
- What are the tools of tax planning
- How tax planning can be implemented
- Which are the major areas of tax planning
- How to do tax planning with respect to non-resident

Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes.

– Learned Hand

Taxpayer may engineer his transactions to minimize taxes, but he cannot make a transaction appear to be what it is not.

– Irving Loeb Goldberg

CONCEPT OF TAX PLANNING

Tax Planning is an exercise undertaken to minimize tax liability through the best use of all available allowances, deductions, exclusions, exemptions, etc., to reduce income and/or capital gains.

Tax planning can be defined as an arrangement of one's financial and business affairs by taking legitimately in full benefit of all deductions, exemptions, allowances and rebates so that tax liability reduces to minimum. In other words, all arrangements by which the tax is saved by ways and means which comply with the legal obligations and requirements and are not colourable devices or tactics to meet the letters of law but not the spirit behind these, would constitute tax planning.

The Hon'ble Supreme Court in McDowell & Co. v. CTO (1985) 154 ITR 148 has observed that "tax planning may be legitimate provided it is within the framework of the law. Colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid payment of tax by resorting to dubious methods." Tax planning should not be done with intent to defraud the revenue; though all transactions entered into by an assessee could be legally correct, yet on the whole these transactions may be devised to defraud the revenue. All such devices where statute is followed in strict words but actually spirit behind the statute is marred would be termed as colourable devices and they do not form part of tax planning. All transactions in respect of tax planning must to be in accordance with the true spirit of statute and should be correct in form and substance.

Various judicial pronouncements have laid down the principle that substance and form of the transactions shall be seen in totality to determine the net effect of a particular transaction. The Hon'ble Supreme Court in the case of CIT v. B M Kharwar (1969) 72 ITR 603 has held that, " The taxing authority is entitled and is indeed bound to determine the true legal relation resulting from a transaction. If the parties have chosen to conceal by a device the legal relation, it is open to the taxing authorities to unravel the device and to determine the true character of relationship. But the legal effect of a transaction can not be displaced by a probing into substance of the transaction."

The form and substance of a transaction is real test of any tax-planning device. The form of transaction refers to transaction, as it appears superficially and the real intention behind such transaction may remain concealed. Substance of a transaction refers to lifting the veil of legal documents and ascertaining the true intention of parties behind the transaction.

How Tax is levied

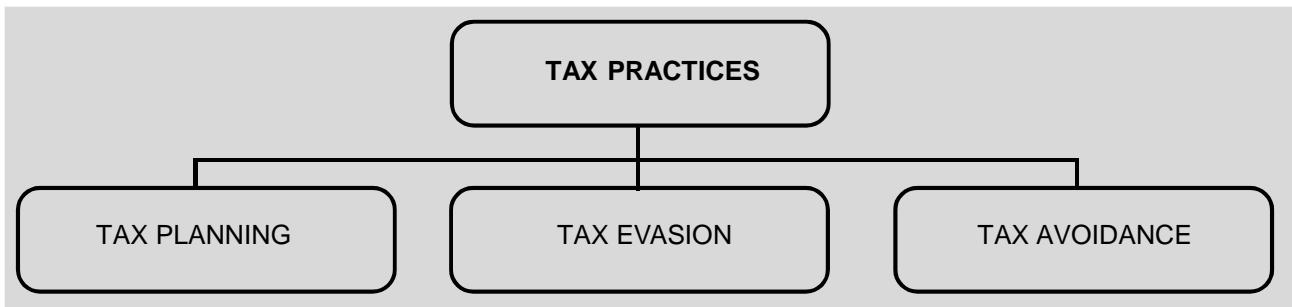
Before a discussion is made concerning the concept of tax planning in detail it needs to be understood as to how tax is levied.

Liability of tax depends upon the charging section in the statute vis-a-vis 'taxable person', 'taxable event' and 'subject matter of taxation'. For understanding these inter-related but distinct concepts reference may be made to the Supreme Court's decision in State of Tamil Nadu v. M.K. Kandaswami (1975, 36 STC 191). No tax is complete nor a charge can rise under a fiscal statute unless the subject, the object and the quantum of tax are prescribed or indicated in the provision. In doing so, there can be different rates of tax levied upon the nature of business/profession carried on or depending on the capacity of the person to pay the tax and/or other relevant consideration. It is now well settled that a modern State, particularly when exercising powers of taxation, has to deal with complex factors/relating to the objects to be taxed, tax to be levied, the social and economic policies etc. Though wide latitude is given to the legislature in the matter of levy of taxes, what is needed is that the tax/statute should be constitutionally valid to pass the muster of Article 14 of the Constitution of India. Article 265 of the Constitution of India prescribes that "no tax shall be levied or collected except by authority".

No income should be taxed presumptively. There is no equity about taxation and no income should be taxed twice.

TAX PLANNING, TAX AVOIDANCE AND TAX EVASION

In India the tax laws are admittedly complicated because of various deductions, exemptions, relief and rebates. Therefore, it is only logical that taxpayers generally plan their affairs so as to attract the least incidence of tax. However, practice of avoidance is worldwide phenomenon and there is always a continuing battle in this regard between the taxpayer and the tax collector. The perceptions of both are different. The taxpayer spares no efforts in maximising his profits and attracting the least incidence. The tax gatherer, on the other hand, tries to break the plans whose sole objective is to save taxes.



In the context of saving tax, there are three commonly used practices, namely (a) Tax Evasion; (b) Tax Avoidance; (c) Tax Planning. They are being considered in greater details in subsequent discussion.

(a) TAX EVASION

It refers to a situation where a person tries to reduce his tax liability by deliberately suppressing the income or by inflating the expenditure showing the income lower than the actual income and resorting to various types of deliberate manipulations.

An assessee guilty of tax evasion is punishable under the relevant laws. Tax evasion may involve stating an untrue statement knowingly, submitting misleading documents, suppression of facts, not maintaining proper accounts of income earned (if required under the law) omission of material facts in assessments. An assessee who dishonestly claims the benefit under the statute by making false statements, would be guilty of tax evasion.

Tax evasion is a method of evading tax liability by dishonest means like suppression, showing lower incomes, conscious violation of rules, inflation of expenses etc. This device has to be condemned. It is a dubious way of attempting to get tax gains. A tax evader has to pay not only penalty but he also incurs the risk of being prosecuted. Tax evasion can never be construed as tax planning because it amounts to breaking of law whereas tax planning is devised within the legal framework by availing of what the legislature provides. Tax planning ensures not only accrual of tax benefits within the four corners of law but it also ensures that tax obligations are properly discharged so as to avoid penal provisions.

(b) TAX AVOIDANCE

The line of demarcation between tax planning and tax avoidance is very thin and blurred. There could be elements of malafide motive involved in tax avoidance also. Any planning which, though done strictly according to legal requirements defeats the basic intention of the Legislature behind the statute could be termed as instance of tax avoidance. It is usually done by adjusting the affairs in such a manner that there is no infringement of taxation laws and by taking full advantage of the loopholes therein so as to attract the least incidence of tax.

Earlier tax avoidance was considered completely legitimate, but at present it may be illegitimate in certain situations. In the judgement of the Supreme Court in McDowell's case 1985 (154 ITR 148) SC, tax avoidance has been considered as heinous as tax evasion and a crime against society. Most of the amendments are now aimed at curbing practice of avoidance.

The types of cases that come under 'Tax avoidance' are those where the tax payer has apparently circumvented the law, without giving rise to an offence, by the use of a scheme, arrangement or device though of a complex

nature, whose main or sole purpose is to defer, reduce or completely avoid the tax payable under the law. Sometimes, the avoidance is accomplished by shifting the liability for tax to other person not at arm's length in whose hands the tax payable is reduced or eliminated. According to G.S.A. Wheat Craft, "tax avoidance is the act of dodging tax without actually breaking the law". It is a method of reducing incidence of tax by taking advantages of certain loopholes of tax laws. Thus, the line of demarcation between tax avoidance and tax planning is very thin and blurred. There is an element of malafide motive involved in tax avoidance.

The Royal Commission on Taxation for Canada has explained the concept of tax avoidance as under :

For our purposes the expression "Tax Avoidance" will be used to describe every attempt by legal means to prevent or reduce tax liability which would otherwise be incurred, by taking advantage of some provisions or lack of provisions of law. It excludes fraud, concealment or other illegal measures".

(c) TAX PLANNING

It means arranging the financial activities in such a way that maximum tax benefits are enjoyed by making use of all beneficial provisions in the tax laws which entitle the assessee to get certain rebates and reliefs. This is permitted and not frowned upon by law.

Thus, tax planning would imply compliance with the taxation provisions in such a manner that full advantage is taken of all tax exemptions, deductions, concessions, rebates and reliefs permissible under the Income Tax Act so that the incidence of tax is the least.

Tax planning can neither be equated to tax evasion nor to tax avoidance with reference to a person, it is the scientific planning of the person's operations in such a way so as to attract minimum liability to tax or postponement or for that matter deferment of the tax liability for the subsequent period by availing various incentives, concessions, allowances, rebates and relief's provided for in the tax laws. They are meant to be availed of and they have certain clear objectives to achieve.

Tax planning may, therefore, be regarded as a method of intelligent application of expert knowledge of planning a person's affairs with a view to securing consciously provided tax benefits on the basis of the national priorities in consonance with the interests of the State and the public.

Therefore, notwithstanding the legal rulings in cases like McDowell and its English parallels, real and genuine transactions aimed at a valid tax planning cannot be turned down merely on grounds of reduction of the tax burden.

While planning a scheme relating to tax affairs, what needs to be assured is that tax planning device does not lose its efficiency due to changes in law. It would be a shortsighted perspective to think of a planning device that is in conformity with the law as it exists, but gets nullified by a subsequent change in law specially where the change is of a retrospective nature. Hence, the tax plan has to be flexible in nature. Flexibility has to be considered as a practical feature in a tax system. Hence, a planner has to comprehend about the future scenario too while devising a plan to save tax.

In the context of corporate taxation since the incidence of tax on Indian companies is considered quite high the scope for ploughing back of profits for expansion and modernisation of the existing plant and machinery etc. is considerably narrowed down. Thus the company has to plan its taxation in such a way that will enable it to avail the tax incentives etc. provided by the Government to the maximum.

OBJECTIVES OF TAX PLANNING

Tax planning, in fact, is an honest and rightful approach to the attainment of maximum benefits of the taxation laws within their framework. Therefore, the objectives of tax planning cannot be regarded as offending any concept of the taxation laws and subjected to reprehension of reducing the inflow of revenue to the Government's coffers, so long as the tax planning measures are in conformity with the statute laws and the judicial expositions thereof. The basic objectives of tax planning are:

- (a) Reduction of tax liability
- (b) Minimisation of litigation
- (c) Productive investment
- (d) Healthy growth of economy
- (e) Economic stability

(a) Reduction of tax liability

In this context, a tax payer can derive the maximum savings by arranging his affairs in accordance with the requirements of law, as contained in the fiscal statutes. In many cases, a taxpayer may suffer heavy taxation not on account of the dosage of tax administered by the Act, but, because of his lack of awareness of the legal requirements. Since every taxpayer wishes to retain a maximum part of his earnings, rather than parting with it and facing the resource crunch, it would be to his benefit to plan his tax affairs properly and avail the deductions and exemption admissible under the Act (s). He can succeed in doing so by keeping an awareness of the implications of the various business/other transactions as well as updation of his knowledge about the various concessions for which he is eligible.

(b) Minimisation of litigation

A general visualisation of the tax administration scenario depicts a tug-of-war the tax payers trying their maximum to pay the least tax and the tax administrator attempting to extract the maximum. This also results in, sometimes, protracted litigations. It is in this context that a sound tax planning pays dividends. Where a proper tax planning is adopted by the tax payer in conformity with the provisions of the taxation laws, the incidence of litigation is minimised. This saves him from the hardships and inconveniences caused by the unnecessary litigations, which at times even stretch upto the High/Supreme Court levels’:

(c) Productive Investment

Channelisation, by a tax payer, of his otherwise taxable income to the various investment schemes too is one of the prime objectives of tax planning as it is aimed to attain twin-objectives : (i) to harness the resources for socially productive projects, and, (ii) to relieve the tax payer not only from the initial brunt of taxation, but also to convert the earnings so made into means of further earnings. Legal awareness of the avenues so provided by the Government, from time to time, negates the imperative avoidance/evasion ends lend authenticity to the investments made.

(d) Healthy Growth of Economy

The growth of a nation’s economy is synonymous with the growth and prosperity of its citizens. In this context, a saving of earnings by legally sanctioned devices fosters the growth of both, because savings by dubious means lead to generation of black money, the evils of which are obvious. Conversely, tax-planning measures are aimed at generating white money having a free flow and generation without reservations for the overall progress of the nation. Tax planning assumes a great significance in this context.

(e) Economic Stability

In the context of the case, *M.V.Valliapan v. ITO*, (1988) 170 ITR 238 (Mad.), by a proper tax planning, a smooth tax flow from the tax payer to the tax administrator, without recriminations, is ensured. This results in economic stability by way of: (i) availing of avenues for productive investments by the tax payers and, (ii) harnessing of resources for national projects aimed at general prosperity of the national economy and reaping of benefits even by those not liable to pay tax on their incomes.

IMPORTANCE OF TAX PLANNING

We cannot deny the fact that tax planning is important for reducing the tax liability. It is also considered important on account of the following factors :

- (i) When an assessee has not claimed all the deductions and relief, before the assessment is completed, he is not allowed to claim them at that the time of appeal. It was held in *CIT v. Gurjargravures Ltd.* (1972) 84 ITR 723 that if there is no tax planning and there are lapses on the part of the assessee, the benefit would be the least.
- (ii) Tax planning exercise is more reliable since the Companies Act, 1956 and other allied laws narrow down the scope for tax evasion and tax avoidance techniques, driving a taxpayer to a situation where he will be subjected to severe penal consequences.
- (iii) Presently, companies are supposed to promote those activities and programmes, which are of public interest and good for a civilised society. In order to encourage these, the Government has provided them with incentives in the tax laws. Hence a planner has to be well versed with the law concerning incentives.
- (iv) With increase in profits, the quantum of corporate tax also increases and it necessitates the devotion of adequate time on tax planning.
- (v) Tax planning enables a company to bear the burden of both direct and indirect taxation during inflation. It enables companies to make proper expense planning, capital budget planning, sales promotion planning etc.
- (vi) Repairs, renewals, modernisation and replacement of plant and machinery are indispensable for an industry for its continuous growth. The need for capital formation in the corporate sector cannot be ignored and heavy taxation reduces the inflow of corporate funds. Capital formation helps in replacing the technologically obsolete and outdated plant and machinery and enables the carrying on of manufacturing operation with a new and more sophisticated system. Any decision of this kind would involve huge capital expenditure which is financed generally by ploughing back the profits, utilisation of reserves and surplus along with the availing of deductions are revenue expenditure incurred for undertaking modernisation, replacement, repairs and renewal of plant and machinery etc. Availability of accumulated profits, reserves and surpluses and claiming such expenses as revenue expenditure are possible through proper implementation of tax planning techniques.
- (vii) In these days of credit squeeze and dear money conditions, even a rupee of tax decently saved may be taken as an interest-free loan from the Government, which perhaps, an assessee need not repay.

Thus, any legitimate step taken by an assessee (being a company) directed towards maximising tax benefits, keeping in view the intention of law, will not only help it but also the society since it promotes the spirit behind the legal provisions. All those companies which practice tax planning may have the satisfaction that they are contributing their best to the nation's broad objectives and goals in a welfare State like ours. At the same time, the law makes the fulfillment of certain conditions obligatory before allowing the benefits to be claimed by the companies. In this way, the companies, besides helping themselves, also help in securing the objectives, tasks and goals set before them by the country.

DIVERSION OF INCOME AND APPLICATION OF INCOME

The Supreme Court's verdict in *CIT v. Sitaldas Tirthdas* (1961) 41 ITR 367 is the authority for the proposition that where by an obligation income is diverted before it reaches the assessee, it is deductible from his income as for all practical purposes it is not his income at all but where the income is required to be applied to discharge an obligation after it reaches the assessee, it is not deductible. Thus, there is the difference between diversion of

income by an overriding title and application of income as the former is deductible while the latter is not. Thus, when management of a company is taken over by another person from the existing team in consideration of percentage of future profits to the latter, in computing the business income of the former, such percentage of profits is deductible [CIT v. Travancore Sugars and Chemicals Ltd. (1973) 88 ITR 1 (SC)]. Management agreements must therefore be drafted with caution.

The Delhi High Court's verdict in CIT v. Stellar Investments Ltd. (1991) 192 ITR 287 to the effect that the Assessing Officer in terms of the power available to him under Section 68 of the Act, is not precluded from ascertaining the genuineness of the share capital, must be needed. There have been occasions when unscrupulous promoters have ploughed back their black money into new companies by subscribing to shares in thousands of fictitious names. If the bluff is called, the unexplained credit in the form of share capital would be treated as income under Section 68 of the Act.

ESSENTIALS OF TAX PLANNING

Successful tax planning techniques should have following attributes :

- (a) IT should be based on upto date knowledge of tax laws. Not only is an uptodate knowledge of the statute law necessary, assessee must also be aware of judgments made through various decisions of the courts. In addition, one must keep track of the circulars, notifications, clarifications and Administrative instructions issued by the CBDT from time to time.
- (b) The disclosure of all material information and furnishing the same to the income-tax department is an absolute pre-requisite of tax planning as concealment in any form would attract the penalty clauses – the penalty often ranging from 100 to 300% of the amount of tax sought to be evaded. Section 271(1)(c) read together with explanations there to.
- (c) Whatever is planned should not simply satisfy the requirements of law by complying with legal provisions as stated and meeting the tax obligations but also should be within the framework of law. It means that sham transactions or make-believe transactions or colourable devices, which are entered into just with a view to circumvent the legal provisions, must be avoided.

Every citizen is obliged to honestly pay the taxes. Therefore, only colourable devices resorted to by the tax payers for evading a tax liability will have to be ignored by the court. Accordingly, a tax planning within the four corners of the taxation laws is not to be turned down only because it legitimately reduces the tax inflow to the Government. A genuine tax-planning device, aimed at carrying out the rules of law and Court's decisions and to overcome heavy burden of taxation, is fully valid.

- (d) A planning model must be capable of attainment of the desired objectives of a business and be amenable to its possible future changes. Therefore, all the important areas of corporate planning, whether related to strategic planning, project planning or operational planning involving tax considerations for long-term or short-term management objectives and policies should be strictly scrutinised in relative situations. Foresight is the essence of a business. Tax planning is one of its important attributes.

TYPES OF TAX PLANNING

The tax planning exercise ranges from devising a model for specific transaction as well as for systematic corporate planning. These are:

- (a) Short-range and long-range tax planning.
- (b) Permissive tax planning.
- (c) Purposive tax planning.

(a) Short-range planning & Long-range planning

Short-range planning refers to year to year planning to achieve some specific or limited objective. For example, an individual assessee whose income is likely to register unusual growth in particular year as compared to the preceding year, may plan to subscribe to the PPF/NSC's within the prescribed limits in order to enjoy substantive tax relief. By investing in such a way, he is not making permanent commitment but is substantially saving in the tax. It is one of the examples of short-range planning.

Long-range planning on the other hand, involves entering into activities, which may not pay-off immediately. For example, when an assessee transfers his equity shares to his minor son he knows that the Income from the shares will be clubbed with his own income. But clubbing would also cease after minor attains majority.

(b) Permissive tax planning

Permissive tax planning is tax planning under the express provisions of tax laws. Tax laws of our country offer many exemptions and incentives.

(c) Purposive tax planning

Purposive tax planning is based on the measures which circumvent the law. The permissive tax planning has the express sanction of the Statute while the purposive tax planning does not carry such sanction. For example, under Sections 60 to 65 of the Income-tax Act, 1961 the income of the other persons is clubbed in the income of the assessee. If the assessee is in a position to plan in such a way that these provisions do not get attracted, Such a plan would work in favour of the tax payer because it would increase his disposable resources. Such a tax plan could be termed as 'Purposive Tax Planning'.

AREAS OF TAX PLANNING IN THE CONTEXT OF INCOME TAX ACT, 1961

Some of the important areas where planning can be attempted in an organised manner are as under:

- (a) Form of organisation/ownership pattern;
- (b) Locational aspects;
- (c) Nature of business.
- (d) Tax planning in respect of corporate restructuring;
- (e) Tax planning in respect of financial management;
- (f) Tax planning in respect of employees remunerations;
- (g) Tax planning in respect of specific managerial decisions;
- (h) Tax planning in respect of Non-Residents.

FORM OF THE ORGANISATION

We have indicated above some of the important areas where tax planning can be attempted. In this Lesson we shall discuss the first aspect of setting up of new business entity, namely form of organisation/ownership pattern. The selection of particular form of organisation depends not only on the magnitude of financial requirements and owner's liability, but also on the tax considerations. In the case of a company, the law interferes with the corporate planning process from the moment it comes into existence. At times, tax laws affect even the periods prior to the existence of a company and it can also extend upto the point of time when the company ceases to exist. For example, a director of a private limited company in liquidation, has to keep in view the provisions of Sections 178 and 179 of the Income Tax Act, 1961 dealing with misfeasance etc. Normally, depending upon the level of operation, expected profitability need for external financing and expected requirements of technical expertise, a suitable form can be chosen. But in view of the continuity of business, the benefits arising out of limited liability,

organised accounting and the overall long-term tax benefits flowing to the company form of organisation, the corporate enterprise may be regarded as an effective instrument of tax planning. The company being a separate legal entity, confers certain valuable benefits in the matter of tax planning to its shareholders and the persons connected with the management of the company.

Tax liability is an important consideration guiding the choice of a legal form of business organisation. In some circumstances however this consideration is of no significance. For example large business is generally compelled to organise itself in the form of a company as this form of organisation makes it possible to raise large amounts of capital required. Similarly retail business of small size can only be economically operated as proprietorship or partnership firm. When there is freedom of choice taxation becomes an important consideration.

(A) Company Form of Organisation

The important tax privileges and advantages to a company over the other forms can be summarized as under:

- (i) Allowability of remuneration, for the persons who are managing the affairs of the company and also owning its shares.
- (ii) The provisions relating to clubbing of income under Section 64 of the Income Tax Act, 1961 do not apply even if the business is carried on by family members through a company, which ultimately leads to reduction in liability to tax on the part of the individual members. However, if spouse of an individual having a substantial interest in a company receives remuneration from the same company, such remuneration is added to the income of the individual unless the spouse is technically or professionally qualified. [Section 40A(2)(b) of the Income Tax Act, 1961].
- (iii) Any income by way of dividend referred to in Section 115-O is exempt under Section 10(34).
- (iv) Companies are subjected to flat rate of tax, regardless of the quantum of their income. The domestic companies now pay tax @ 30% plus surcharge @ 5% (surcharge is applicable if their total income exceeds ₹ 1 Crore), if applicable and education cess @ 3%.. This, however, may not seem to be an advantage in view of low slab rates applicable to sole proprietorships, but when we look at the total incidence of tax after taking into account the various deductions allowed to companies and the scheme of perquisites, the real owners of companies stand to benefit.
- (v) There are certain special tax concessions, allowances and deductions given under the Income Tax Act, 1961 available to the company form of business enterprises such as deductions allowed under Section 33AC and Sections 36(1)(ix) and 35D of the Income Tax Act, 1961 etc.
- (vi) Incorporation of a company has the incidental advantage of attracting large capital since the shareholder, who has to contribute only a minuscule part of the capital requirements, is assured of limited liability and free transferability of his shares. That shares in companies are treated as long term capital assets qualifying for considerable leniency in taxation even if they are held by the assessee for a small time as 12 months, has made investment in the shares of companies all the more attractive. This helps the companies to generate the funds required for their development as well as furtherance of their objects.
- (vii) There is no wealth tax on shares of company w. e. f. Assessment Year 1993-94. In case there is every likelihood of growth of business in future years a partnership firm or sole proprietorship business may be formed initially and may be converted into a company later, on growth of business as the average rate of tax applicable for non-corporate assessee is less than the flat rate applicable to corporate assessees.

The relative tax burden of conducting business can be assessed by paying attention to the provisions of the Income-tax Act, 1961, Income-tax Rules, 1962 and various other notifications and circulars issued from time to time by concerned authorities.

An individual pays tax on his income on the basis of slab system. He gets the benefit of minimum taxable limit laid down by the respective Finance Acts. Income received by an individual in different capacities, i.e. as a member of a firm is not taxable in hand of partner. Because firm has paid tax on it. The owner of a proprietorship firm is treated as an individual for tax purposes.

A company is regarded as a separate legal entity. The minimum limit does not apply in its case. It is required to pay tax on every rupee of its income. Besides the usual income tax at the flat rate prescribed by the respective Finance Acts, whatever amount of tax is paid by a company is not deemed to have been paid on behalf of the shareholders. Therefore, no rebate is allowed to shareholders in this regard as is the practice in advanced countries.

(B) Partnership Firm or Limited liability Partnership

A partnership form of organization is easy to establish. The only procedure for the formation of partnership is to draw up a partnership deed and a nominal charge in terms of cost of stamps for the deed is to be incurred. This form of organization is suitable due to the following factors:

- The decision making on important business matter is quick as compared to a company form of organization because partners meet frequently together. Therefore, decision on any important business matter cannot be delayed.
- The chance of getting involved in risky activities is very less because every important decision is made with the concurrence of all the partners.
- As compared to sole proprietorship, the problem of raising additional resources is much less. Whenever the business expands and it is necessary to raise finance, it will be easy to raise it by admitting a new partner or raising it by way of borrowings because of number of partners and their joint and several liability to pay the debts of the firm, the lenders will be more interested in lending.
- The firm can pay interest on capital and loan to partners at the maximum rate of 12% p.a. Further it can also give remuneration to its working partners subject to the limits mentioned in Section 40(b).
- This form of organisation is suitable from income-tax point of view in such cases where the amount of profit is not large and the partners of the firm do not have any other additional income except by way of remuneration and interest from the partnership firm. In such a case the profit of the firm shall be lower and the individual partners can also avail of the maximum ceiling of income exempt under the Income-tax Act.
- The share in the profit of the partnership firm is exempt from tax under Section 10(2A) of the Income-tax Act.
- The risk as to losses and liability incurred is divided amongst the partners.
- As in the case of company form of organization where the change of business requires a long procedure, there is no tedious procedure in the partnership form of organization. The business can be changed only with the consent of partners.
- The firm is taxable at a flat rate of 30% + education cess @2% + SHeC @1% for assessment year 2014-15 after allowing interest and remuneration to working partners (if provided in the partnership deed and subject to Section 40(b) of the Income-tax Act.

However this form of organization is not suitable due to the following reasons:

1. The risk taking capacity of the partners becomes limited. Every decision relating to important business matters is made with the consultation of other partners, which restricts the risk taking activities which may yield much higher profits.
2. As far as the operations of business are limited to small or medium scale, there is no problem in financing the expansion of business operation. But when business gets expanded to a large scale, then it will be

suitable to adopt a company form of organization because partnership can be formed up to maximum number of 20 partners.

3. One of the main drawbacks is that one partner becomes liable for the acts of another. Therefore, a partner is liable for the wrongs of another partner if it is done within the legal limits.
4. In the new scheme of assessment of partnership firms, the share of partners is exempt from tax under Section 10(2A) but the partners remuneration and interest, subject to limit mentioned in Section 40(b), is taxable in the hands of the partners under the head profits and gains of business or profession. Also, the firm cannot claim deduction in respect of interest payable to partners in excess of 12% per annum.
5. Where the partnership firm does not comply with the requirements of Section 184 of the Income Tax Act, although the firm shall be assessed as firm, it shall not be allowed any deduction on account of interest and remuneration to its partners.
6. A partnership firm may come to a sudden closure of business on account of death, lunacy or insolvency. In the case of a business running efficiently and profitably, such as happening will cause a great loss. Also, dissolution will attract Section 45(4) which imposes tax liability in respect of capital gain arising on transfer of capital assets from the firms to partners.

Entrepreneurs now have an alternative and innovative form of business organization i.e. Limited Liability Partnership (LLP) which combines the benefits of company and general partnership form of business organizations. LLP has separate legal entity, perpetual succession and limited liability of partners. From income tax point of view it is treated same as general partnership firm therefore its profits will be taxed in the hands of the LLP not in the hands of its partners.

(C) Sole proprietorship

The most common form of ownership found in the business world is sole proprietorship. In this form of organization, the proprietor is the only owner of the business assessed and he is solely responsible for the affairs of the business.

- A sole proprietorship is easy to establish because of little interference of government regulations.
- The cost of adopting this form of organization is small because of there being no legal requirement.
- All the profits of the business go in the hands of proprietor himself.
- In case of persons carrying on business on small scale and having small income from other sources, this form of organization would be suitable because the proprietor can avail of the ceiling of exempt income as under:

For assessment year 2014-15:	
(a) in case of individuals in India below 60 years of age.	2,00,000
(b) in case of individual resident in India who is of the age of 60 years or but below the age of 80 years at any time during the previous year	2,50,000
(c) in case individual who is the age of 80 years or above	5,00,000

The tax liability of the individual will be minimum as the individual is subject to income-tax at slab rate and the maximum marginal rate of income-tax in his case is 30% plus education cess @2% plus SHEC @1% for the assessment year 2014-15.

- Besides the deductions which are allowed to all assesses under Chapter VIA, a sole proprietor, being assessed as individual, is entitled to get certain deductions under the following sections:
 - (i) Section 80C relating to contributions to provident fund, life insurance premium, subscription to certain equity shares or debentures, etc.

- (ii) Section 80CCC relating to contribution to certain pension funds.
- (iii) Section 80CCD relating to contribution to notified pension scheme of the Central Government.
- (iv) Section 80D relating to medical insurance premia.
- (v) Section 80DD relating to maintenance of a dependent who is a person with disability.
- (vi) Section 80DDB relating to expenditure on medical treatment, etc.
- (vii) Section 80E relating to interest taken for higher education.
- (viii) Section 80GG relating to rent paid.
- (ix) Section 80QQB relating to royalty income, etc. of authors of certain books other than text books.
- (x) Section 80RRB relating to royalty on patents.
- (xi) Section 80U relating to persons with disability.

However, this form of organization is also not suitable due to:

- The liability of the proprietor is unlimited and it can extend even to his personal assets. When the proprietor incurs losses and business assets are not sufficient enough to meet the liabilities of business, his personal assets can be used for discharging the business liabilities.
- The proprietor does not get deduction on account of remuneration payable to him attributable to the rendering of services. It is felt that it is the capital contributed and risk taken by the proprietor for which he is rewarded in profits and that he must be given remuneration for the service rendered by him which should be allowed as deductible expenditure. But this is not so in income-tax law.
- Another main drawback of this form of organization is that it does not provide opportunities to finance the expanding business activities. In the case of a partnership firm, on the other hand, finance can be raised by the existing partners or by entering another partner.

(D) Hindu Undivided Family

A joint Hindu family pays tax on its total income at prescribed rates on the basis of slab system. The family can pay reasonable remuneration to the Karta and other family members for their services to the business and it is allowed as a deduction in computing the business income. However, interest on capital contributed by the family for the business is not deductible in computing business income. The member of the family, who has received the remuneration from the family will include it in his income under the head Salaries.

A Hindu undivided family will also get a basic exemption of ₹ 2,00,000 from assessment year 2013-14. Besides the deductions which are allowed to all assesses, it is allowed certain deductions under Sections 80C, 80D, 80DD, 80DDB and 80GG like individuals. The tax rates in case of HUF are same as applicable to individual.

The demerits of HUF, however, are similar to that of individuals.

LOCATIONAL ASPECTS

Tax planning is relevant from location point of view. There are certain locations which are given special tax treatment. Some of these are as under:

1. Full exemption under Section 10A for ten years in the case of a newly established industrial undertaking in free trade zones, etc. [Not allowed w.e.f. A.Y. 2012-13].
2. Full exemption under Section 10AA for initial five years, 50% for subsequent five years and further deduction of 50% for a further period of five years in the case of a newly established units in special economic zones on or after 1.4.2005.

3. Full exemption under Section 10B for 10 years in the case of a newly established 100% export-oriented undertaking. [Not allowed w.e.f. 2012-13].
4. Deduction under Section 80-IAB in respect of profits and gains by an undertaking or an enterprise engaged in the development of Special Economic Zone.
5. Deduction under Section 80-IB in the case of newly set up industrial undertaking in an industrially backward State or district.
6. Deduction under Section 80-IC in case of newly set up industrial undertaking or substantial expansion of an existing undertaking in certain special category States.
7. Deduction under Section 80-ID in respect of profits and gains from business of hotels and convention centres in specified area or a hotel at world heritage site.
8. Deduction under Section 80-IE in respect of certain undertakings in North-Eastern States.

NATURE OF BUSINESS

Tax planning is also relevant while deciding upon the nature of business. There are certain businesses which are granted special tax treatment. Some of them are as follows:

- Newly established industrial undertaking in free trade zones, etc. [Section 10A]. [Not allowed w.e.f. A.Y. 2012-13].
- Newly established units in special economic zones [Section 10AA].
- Newly established hundred per cent export-oriented undertakings [Section 10B]. [Not allowed w.e.f. A.Y. 2012-13].
- Tea Development Account, Coffee Development Account and Rubber Development Account [Section 33AB].
- Site restoration fund [Section 33ABA].
- Specified business eligible for deduction of Capital Expenditure [Section 35AD].
- Amortisation of certain preliminary expenses [Section 35D].
- Expenditure on prospecting for certain minerals [Section 35E].
- Special reserve created by a financial corporation under Section 36(1)(viii).
- Special provision for deduction in the case of business for prospecting for mineral oil [Sections 42 and 44BB].
- Special provisions for computing profits and gains of business on presumptive basis [Section 44AD].
- Special provisions in the case of business of plying, hiring or leasing goods carriages [Section 44AE].
- Special provisions in the case of shipping business in the case of non-residents [Section 44B].
- Special provisions in the case of business of operation of aircraft [Section 44BBA].
- Special provisions in the case of certain turnkey power projects [Section 44BBB].
- Special provisions in the case of royalty income of foreign companies [Section 44D].
- Special provisions in case of royalty income of non-residents [Section 44DA].
- Certain income of offshore Banking Units and international Financial Service Centre [Section 80-LA].
- Profit and gains of industrial undertakings or enterprises engaged in infrastructure development, etc. [Section 80-IA].

- Profits and gains of an undertaking or an enterprise engaged in development of Special Economic Zone. [Section 80-IAB].
- Profits and gains from certain industrial undertaking other than infrastructure development undertaking [Section 80-IB].
- Special provisions in respect of certain undertakings or enterprises in certain special category States [Section 80-IC].
- Deduction in respect of profits and gains from business of hotels and convention centres in specified area or a hotel at world heritage site. [Section 80-ID].
- Special provisions in respect of certain undertakings in North-Eastern States. [Section 80-IE].
- Profits and gains from the business of collecting and processing of bio-degradable waste [Section 80JJA].
- Employment of new workmen [Section 80JJAA].
- Special tax rate under Sections 115A, 115AB, 115AC, 115AD, 115B, 115BB, 115BA and 115D.

TAX PLANNING RELATING TO CORPORATE RESTRUCTURING

The following suggestions could be useful for tax planning in respect of amalgamation merger, demerger, etc.

1. Since the unabsorbed losses and unabsorbed depreciation cannot be allowed to be carried forward and set off in the hands of the amalgamated company, except in the cases prescribed under Section 72A of the Act, it is proposed:
 - (a) that the scheme of the amalgamation can be put off till such time the full benefit of set off is availed of by the amalgamating company; and
 - (b) that the loss carrying company should absorb or take over the business of the profit-making company. In other words, the profit making company should merge itself with the loss incurring company. This would help in carrying to carry forward the benefits of all unabsorbed losses and depreciation to be set off against the profits derived from the business of the profit-making company.
2. To save from disallowance of the debts of the amalgamating company which subsequently become bad in the hands of the amalgamated company, the amalgamated company should plan to make suitable provision for the expected losses on account of bad debts at the time of fixing the consideration while taking over the business of the amalgamating company.

However, in view of the Court judgment of *CIT v. T. Veerabhadra Rao (1985) 22 Taxmann 45*, the bad debts are not allowed to an assessee by way of personal relief but to a business. So, it is possible for the amalgamated company to claim bad debts even in respect of debts taken over from the amalgamating company.

3. A company whose shares are not quoted on a recognised stock exchange may avail the benefit of amalgamation by amalgamating itself with another company whose shares are quoted on a recognised stock exchange. This would help its shareholders to take the advantage of the quoted price of their shares in the stock exchange.
4. A company holding investments in immovable properties may avail the benefit of non-applicability of the provisions of the Urban Land Ceiling Act by amalgamating itself with an industrial company.
5. A loss incurring company and a profit-making company may merge in order to reduce the overall incidence of liabilities to tax under the Income Tax Act, 1961.

6. In case the conditions provided under Sections 2(1B) and 72A of the Act are not satisfied, it may be suggested that the profit making company should merge itself with the loss making company, so that the loss making company does not lose its existence and also enjoys all other benefits.
7. Under Section 2(1B) of the Act, it is provided that for availing the benefits of amalgamation, at least 75% of the shareholders of the amalgamating company should become shareholders of the amalgamated company. In case more than 25% of the shareholders are not willing to become shareholders of the amalgamated company, it is proposed that the amalgamating company may persuade the other shareholders who may be willing, to purchase the shares in the amalgamated company to acquire the shares of the remaining shareholders so that the percentage of dissenting shareholders does not exceed 25%. Alternatively, the amalgamated company prior to, amalgamation, may purchase shares from such dissenting shareholders so as to make such dissenting shareholders to go below the specified percentage of 25%.

There is a recent trend of going in for reverse merger. It means that the profit making company merges into the sick company thereby becoming eligible to carry forward of losses etc. without the aid of Section 72A of the Act. The profit making or healthy company extinct and loose its name and the surviving sick company retains its name. It is actually device to bypassing merger under Section 72A of the Act and is being increasingly popular now a days.

Invariably soon after the merger or after a year or so, the name of the company is changed to accord with that of the profit making amalgamating company in this way two birds are killed with one stone because : (1) Losses are carried forward, which would otherwise have not been possible; (2) Goodwill, which consists, in the name of the profit making amalgamating company, is also retained. The same route was followed, among others, by Kirloskar Pneumatics Ltd. where the company merged with Kirloskar Tractors Ltd., a sick unit and initially lost its name but after one year it changed its name as was prior to merger. However, it remains to be seen whether the Parliament/Judiciary views this kind of strategy as an exercise resulting in tax-avoidance or not? But, right now, this is not required in view of changes done in Section 2(1B) and 72A of the Act.

TAX PLANNING RELATING TO FINANCIAL MANAGEMENT DECISIONS

When a company raises long term loans from financial institutions or by way of public issue of debentures or inviting deposits from the public, it should plan that the expenses incurred on such issues of debentures or expenses towards stamp duty, registration fees, and lawyer's fees should be incurred only after the date of the 'setting-up' of the business. The interest paid before the commencement of production but after setting up of the business on loans taken by the company for the acquisition of its plant and machinery and other assets, forms part of the actual cost of the asset and it should be capitalized in actual cost of asset. Thus, the company would be allowed to capitalise the expenditure and claim a higher depreciation and investment allowance.

The company should also plan the optimum use of the share capital and the borrowed funds. Note that the borrowings should be utilised as far as possible for the acquisition and installation of assets like, buildings, plant and machinery so that interest can be capitalised for the period after setting up of the acquired assets like buildings, plant and machinery but before the commencement of production. The interest and higher amount of depreciation (due to capitalisation of expense) may be claimed as revenue expenditure pertaining to the business of the company.

The company should also plan to purchase the depreciable assets on credit terms and an agreed amount of interest can be paid on such credit purchases or the company may purchase these company assets on the basis of the hire purchase agreement enabling the company to claim the amount of interest paid as revenue business expenditure. The company would also be entitled to claim either the depreciation for use of the asset or may treat the hire charges as the rent for the asset in the normal course of business and claim deduction on revenue account.

The following table will help the finance manager framing suitable plans relating to capital structure:

	<i>Capital</i>	<i>Borrowings</i>
(a) Dividend/Interest	Not deductible	Fully deductible
(b) Cost of raising finance	1/5th allowed under Section 35D	Fully deductible in first year.

Taking the same sources of finance, the comparison between pre-commencement period and post-commencement period is as follows :

- (a) (i) Dividend is not deductible either for pre-commencement period or in the post-commencement period in India.
- (ii) Interest is capitalised for pre-commencement period, i.e. added to the cost of project' (cost of fixed assets) and its depreciation is calculated on capitalised value of assets. In post-commencement period, interest is fully deductible.
- (b) (i) Cost of raising finance in case of capital is not deductible as revenue expenditure but amortised under Section 35D of the Act. If such expenditure is incurred after the commencement of the business. Section 35D is applicable, provided the expenditure is undertaken for expansion purposes in case of industrial undertaking.
- (ii) Cost of borrowing funds in case of pre-commencement period is capitalised and in case of post-commencement period, it is deductible fully in the year.

The above consideration will go a long way in suggesting the managements of corporate entities to adopt a suitable capital structure and selecting the appropriate financing sources by providing an optimum capital mix for the organization

TAX PLANNING RELATING TO NON-RESIDENTS

Suggested tax planning measures for Non-Resident are:

1. As a Non-resident is not required to pay tax on his income earned and received outside India, an Indian citizen having an assignment abroad could plan his visits to India in such a way so that he could remain to be a Non-Resident for the purpose of the Income Tax Act. This is generally of interest to persons employed in foreign countries.
2. All those dealing with Non-Residents must keep in view the provisions of Sections 162 and 163. They should retain sufficient amounts with them to be paid on behalf of the Non-Resident towards his tax liability, so that they are not obliged to pay such taxes on their own account. They should also keep in view the obligations cast by Section 200, of paying the taxes deducted within the time prescribed so as to avoid applicability of the prosecution provisions under Section 276B.
3. A Non-resident must be very clear as regards his tax liability through agent. He must be aware that the agent will deduct some amount out of the amount payable to the Non-Resident.
4. Persons employed by or on behalf of a Non-Resident, those who have a business connection with Non-Resident and statutory agents are all considered as authorised agents of a Non-Resident. Even a Non-Resident could be treated as the agent of another Non-Resident.
5. It should be remembered that if the agent is unable to recover from the Non-Resident the amount of tax paid on his behalf, he cannot claim it as a bad debt or as business loss in view of Supreme Court decision in *CIT v. Abdullaibhai Abdulkadar* (1961 41 ITR 545).
6. Another very important point is the close financial association between a resident and a Non-Resident. This can also amount to a business connection. In a case where all Indian Banks and a foreign bank were controlled by the same persons and the main function of the foreign bank was to finance the Indian

Bank, it was held that a business connection existed in India between the two banks, *Bank of Chettinad Ltd. v. CIT Madras (PC) (1940) 8 ITR 522*.

- When an individual, being a citizen of India leaves India for purposes of employment, the new explanation under Section 6(1)(c) mitigates the rigor of the provisions about treating a person as resident and ordinarily resident. Under clause (c), an individual is said to be resident in India in any previous year if having been in India for at least 365 days during the four preceding years, he is in India for 60 days in that year. Clause (a) of the new explanation provides that where an individual citizen leaves India in any previous year as a member of the crew of an Indian ship as defined in clause (18) of Section 3 of the Merchant Shipping Act, 1958 (44 of 1958); or for purpose of employment outside India, the period of 60 days will be substituted by 182 days. Likewise, clause (b) provides that where an Indian citizen or a person of Indian origin within the meaning of Explanation to Clause (e) of Section 115C who is outside India comes on a visit to India in the previous year, the period of 60 days referred to in sub-clause (c) will be substituted by 182 days. Thus, they will be Non-Resident in India for that year and as a result salary income earned abroad will not be taxed in India. They may visit India during vacation for 181 days or less, or else if he desires to stay in India for a period longer than 181 days the visit should be so planned over two previous years that his total stay in any one previous year should remain 181 days or less.

In this way they can stay upto 362 days (181 days in one financial year and 181 days in another financial year) at a stretch without becoming resident in any of the two previous years.

Explanation to Section 6(1)(c) had been substituted by Direct Tax Laws (Second Amendment) Act, 1989 and subsequently amended by the Finance Act, 1990 with effect from 1.4.1990 i.e. for and from the assessment year 1990-91. Under the substituted Explanation, it is. provided that in the case of an Individual:

- being a citizen of India, who leaves India in any previous year as a member of the crew of an Indian ship as defined under Section 3(18) of the Merchant Shipping Act, 1958 (44 of 1958, or for the purposes of employment outside India, the provisions of Section 6(1)(c) shall apply in relation to that year as if for the words 'sixty days', the words 'one hundred and eighty two days' had been substituted.
- being a citizen of India, or a person of Indian origin within the meaning of Explanation to Section 115C(e), who being outside India, comes on a visit to India in any previous year, the provisions of Section 6(1)(c) shall apply in relation to that year as if for the words 'sixty days' occurring therein, the words 'one hundred and eighty two days' had been substituted.

TAX PLANNING FOR INDIAN COLLABORATORS

While entering into an agreement for foreign collaboration, the Indian collaborator should take into consideration such aspects as will enable him to plan his tax affairs in a manner that ensures maximum after-tax profits and return on investment. In this context, the Indian collaborator may be advised to adopt the following steps for tax planning:

(i) Capitalisation of installation expenses

As far as purchase of capital goods from the foreign collaborator is concerned, it is needless to say that this is a capital expenditure on which depreciation is admissible. But care should be taken to see that the cost of installation, including the supervision expenses charged by the collaborator, is also capitalised and depreciation claimed thereon, The Indian company should also be vigilant that the other expenses relating to the collaboration agreement must be incurred after the date of the setting up of the business, because only then it would be entitled to be capitalised as other expenses.

(ii) Treating purchase of spares as revenue expenditure

For the purchase of spares for the plant, the Indian collaborator should plan to receive the spares subsequent to the year of commissioning of the plant and preferably execute a separate contract in this behalf. It will enable the

Indian company to treat the whole of the amount of spares as revenue expenditure. In this context, the judgement of the Madras High Court in CIT v. Rama Sugar Mills Ltd. (1052) 21 ITR 191 (Mad.) is worth-noting. A sugar manufacturing company had three boilers at its factories. Two of these were constantly in use and the third one was kept as "spare" ready to be used when one of the other two boilers had to be cleaned up at intervals. The productive capacity of one of the boilers deteriorated and the company was required to purchase the other at a cost of ₹ 85,000. The Madras High Court held that this expenditure was deductible on revenue account, on the ground that "the boiler which was substituted was exactly similar to the old one and by this expenditure, the assessee company did not bring any additional advantage to the trade or business, which they were carrying on and there is no improvement. It cannot be suggested that by using a new boiler for an old one, the production capacity of the sugar manufacturing unit was in any manner increased".

(iii) Treating plans and drawings, etc. as "Plant for availing of full value as depreciation"

In view of the Supreme Court's decision in the case CIT v. Alps Theatre, (1067) 65 ITR T77 (S.C.) "Plant" includes ships, vehicles, books, scientific apparatus, and surgical equipments used for the purpose of business or profession.

However, know how acquired on or after 1.4.1998, owned wholly or partly by the assessee and used by such assessee for the purpose of his business or profession, will form a separate block of asset alongwith other intangible asset and will be eligible for depreciation under section 32(1) @ 25% on written law value.

TAX PLANNING FOR EMPLOYEES

The employees should keep the following aspects in view while planning their salary package:

- (i) The employee should opt for division of salary into basic pay and allowances and should not opt for the consolidated salary. This will minimise his tax incidence considerably as some of the allowances are exempt from tax upto a certain extent for e.g. conveyance allowance is exempt upto ₹800 p.m.
- (ii) Under the terms of employment, dearness allowance should form part of the retirement benefits. This will not only increase the employees retirement benefits but also reduce his tax incidence in respect of HRA, gratuity, commuted pension, employer's contribution to RPF, etc.
- (iii) Any commission payable as per the terms of employment should be based on turnover so as to form part of salary. This will also reduce the tax incidence in respect of HRA, commuted pension, interest credited to RPF, etc.
- (iv) If the employee is allowed the use of more than one car for his private purposes, the horse power of any such car should not exceed 1.6 litre cubic capacity as otherwise he shall be deemed to have been provided with one car of 1.6 cubic litre capacity which would lead to higher valuation of such perquisite.
- (v) The employer's contribution to RPF should be 12% of salary as it is exempt upto this limit.
- (vi) The employee should opt for re-imbursement of expenses on medical treatment (on free medical facility) in place of medical allowance because such allowance is taxable whereas the reimbursement is not taxable upto the extent of ₹ 15,000. The same thing holds good for entertainment allowance.
- (vii) Perquisites should be preferred to taxable allowances. This shall help not only in lower valuation of a perquisite like rent free house but the employee will also be free from falling into the category of specified employees.
- (viii) It may be noted that if furniture is provided without rent free accommodation, it will not be taxable in the hands of non-specified employees.
- (ix) An employee who resigns before completing five years of continuous service in an organisation, should ensure that the new organisation he joins maintains RPF so that the accumulated balance of the provident fund could be transferred to the new organisation to claim exemption thereon.

- (x) On retirement, the employee should opt for commuted pension to the maximum permissible limit as it is exempt from tax within certain limits.
- (xi) Leave encashment should preferably be done on termination of employment by superannuation or otherwise as it will then be exempt from tax within certain limits.

In addition to the above, the employees should also plan for taking full advantage of the relevant provisions under Section 80C to 80U of the Income Tax Act.

TAX PLANNING UNDER WEALTH TAX ACT

As measures of tax planning, companies can take the following precautions:

- (a) As far as possible, companies should avoid to invest in taxable assets like, jewellery, motor cars, other unproductive assets etc.
- (b) Alternatively, in unavoidable cases, the investment in the said assets could be made out of loan or a debt may be incurred in relation thereto, by way of furnishing a security for a loan. For example, companies generally finance the purchase of assets like, motor cars/trucks/vehicles etc., through bank loans/overdrafts/mortgage.
- (c) Likewise, purchase of a house property likely to be used by the Directors/ Manager/Secretary as their residential accommodation or by any other employee who has a substantial interest in the company (holding at least 10% equity shares of the company) could be funded out of loan/raising of debts thereon.

The strategy will help the company to dilute the incidence of tax on its wealth.

CHARITABLE INSTITUTIONS

Associations having charitable object viz., promotion of commerce, art, science, religion, charity or any other useful object by nature, can be registered as companies under Section 25 of the Companies Act, 1956, and avail the benefits of a company form of organisation from the point of view of the Companies Act, as well as the various tax concessions available to widely-held companies under the Income tax Act and also claim exemption from, Wealth tax and total exemption from Income tax under Section 11 of the Income Tax Act subject to the conditions specified in Section 13 thereof.

LEGISLATIVE AMENDMENTS

It is a common feature of modern legislative system to lay down in the Acts, the principles and the policy of the legislature leaving out details to be filled-in or worked-out by rules or regulations made either by the Government or by some other authority as may be empowered in the legislations. This kind of subordinate or administrative legislation is justified and even necessitated by the fact that the legislature has neither the time nor the material to consider and act with reference to various details. Not only that they may not be even acquainted fully with the facts and circumstances relating to the subject matter. Section 295(1) of the Income-tax Act and Section 46(1) of the Wealth Tax Act respectively vest in the Central Board of Direct Taxes the power to give retrospective effect to any of the rules in such a way as not to prejudicially affect the interest of the tax payers.

The various matters in respect of which the rules may be framed are specified in the relevant sections. Section 119 read together with Section 295 empowers Central Board for Direct Taxes to frame rules, issue circulars, notifications, administrative instructions to the sub-ordinate authority for smooth functioning of the Income Tax Act, 1961. Section 119 read together with Section 295 gives general powers to Central Board for Direct Taxes to frame the rules and notifications. However, relevant sections empower Central Board for Direct Taxes to frames rules and issue relevant notifications. For example, Section 44AA provides that certain persons carrying on profession or business such as legal, medical, architectural or interior decoration or the profession of accountancy or technical consultancy or any other profession as is notified by the Board. Therefore, on careful perusal of

Section 44AA, it may be seen that this Section empowers Central Board for Direct Taxes to issue notification to the effect that other professions shall be covered by the provision of Section 44AA for maintenance of books of account.

STATUTORY FORCE OF THE NOTIFICATIONS

Section 296 of the Income Tax Act, 1961 provides that the Central Government shall cause every rule made under this Act or for that matter any notification issued, to place before both the Houses of Parliament either before issuing them or in case same is issued when Parliament is not in session immediately thereafter when the Houses are in session. Rules and notifications are made by the appropriate authority in exercise of the power conferred on it under the provisions of the Act. For the A.Y. 2008-09, notification includes every notification issued before the 1-6-07 under Section 10(23C)(iv). Therefore, they have statutory force and can be equated to the law made by the legislature itself. Thus, they are a part and parcel of the enactment. The rules cannot, however, take away what is expressly conferred by the Act. In other words, they cannot whittle down the effect of the law. The rules are only made in consonance with provisions of the Act. They must be interpreted in the light of the section under which they are made. If there is any irreconcilable conflict between a rule and a provision in the Act, the provision in the Act will prevail.

Notifications when validly made in exercise of the authority provided for in the law, are equally binding on all concerned and may be enforced. (As for press notes, although they have no statutory force as such, they are binding on the officers). Section 119(1) of the Income-tax Act provides that all officers and other persons employed in the execution of the said Act shall observe and follow the orders, instructions and directions of the Board, provided that such orders, instructions or directions shall be issued as not to interfere with the discretion of the Appellate Assistant Commissioner in the exercise of his appellate functions.

It is judicially settled that the circulars issued by the Board would be binding under Section 119 on all the officers and persons employed in the execution of the Act [Navnital Javeri v. Sen (1965) 56 ITR 198 (SC)]. If an Income Tax Officer contravenes any circular issued by the CBDT in any respect, he can be called-upon by the appropriate authority including the Commissioner/Commissioner (Appeals), and the Appellate Tribunal to give effect to it. Though the Circular is not the same footing as a rule, it can be taken judicial note of. However, it may be noted that an opinion expressed by the Board in individual communications to the assessee (for example, as to when the new industrial undertaking established by the assessee began to manufacture or produce articles within the meaning of Section 80(I) cannot be considered as directions binding on the income tax authorities under Section 119. The Board is not competent to give directions where the exercise of any quasi judicial discretion by the subordinate authorities in individual cases is involved. [J.K. Synthetics Ltd. v. CBDT (1972) 83 ITR 335 (SC)]. It has been clarified by the Supreme Court in Kerala Financial Corporation v. CIT 210 ITR 129 that Section 119 does not empower the CBDT to issue order, instruction or direction overriding the provisions of the Act. That would be destructive of all known principles of law as the same would really amount to giving power to a delegated authority to even amend the provisions of law enacted by the Parliament. Under Section 119 CBDT also cannot issue order for a specific case.

Normally, exemptions should be specifically provided by the Statute giving exemptions. Where schedules and notifications are issued as empowered by the statute, the exemptions given by the notification would be legally valid as if were given by the statute itself. In the case of Collector of Central Excise v. Parle Exports (P) Ltd. (1990, 183 ITR 624), the Supreme Court had held that when a notification is issued in accordance with powers conferred by the statute, it has statutory force and validity and therefore, it is as if the exemptions under the notification were contained in the Act itself.

The various judicial rulings point out the following:

- (1) The instructions of the Board are binding on the Department but not on the assessee.
- (2) The instructions have to be followed by the Departmental Officers. Instruction adverse to an assessee's interest can be challenged by him.
- (3) The instructions withdrawn subsequently should be given effect to by the Assessing Officer for the assessment year for which they were in force even though they are withdrawn at the time he makes the assessment.
- (4) In the exercise of its power, the Board cannot impose a burden or put the assessee in a worse position.

In view of this position, the tax planner, while planning his affairs or that of his clients must take into account not only the relevant legal provisions which affect him but also all relevant rules, notifications, circulars etc. As for circulars, since they are in the nature of administrative or executive instructions, the possibility that they might be withdrawn by the Board at any time, should also be taken into account. They may be challenged in the courts although, otherwise, they are binding at the administrative level. In cases where the circulars are based on an erroneous or untenable footing, they are liable to be quashed by the courts.

ORGANISATION OF TAX PLANNING CELLS

Some companies can afford to have separate tax planning departments while others cannot. The need for having tax planning department does not depend upon the amount of tax liability of the company. In fact, in certain cases, companies having effective tax planning cells can plan their transactions with a view to attract the least incidence of tax. Organisation of such a cell can be justified on the following grounds :

(a) Complexity and volume of work

Where the volume of tax work to be handled is large and highly complex, then it is required to appoint a special tax expert along with the required staff.

(b) Separate Documentation

Documentation is an indispensable ingredient of tax management. An assessee has to keep reliable, complete and updated documentation for all the relevant tax files so that the documentary evidence can be made available at a short notice whenever it is required. In absence thereof, an assessee may lose a case for want of proper documentary evidence. Not only that the company has to maintain proper account books, records, vouchers, bills, correspondence and agreements, etc. as a part of tax management. In the case of new industrial undertaking it is better to keep separate accounts for the same.

(c) Data Collection

The staff concerned with taxation has to collect and keep on collecting data relating to latest circulars, case laws, rules and provisions, and other government notifications to keep abreast of the current developments. This could also guide them in any particular area, when such guidance is needed. The composition of organisation of such data bank may vary from one organisation to another. However, keeping in view the general areas of operation of the company, it may, be advisable to arrange the data in the order of subject sequence. This would enable easy availability of information at the relevant time.

(d) Integration

Tax planner should be consulted by all the departments of the company to know the impact of taxation on their decisions. It would be necessary to integrate and properly link all the departments of the company with the tax planning department. Any project or blue print may have a tax angle. This has to be identified early enough to facilitate better tax compliance and availing of the several incentives. The department has to deal with all taxes (both State, Central and Local Self Governments).

(e) Constant Monitoring

In order to obtain the intended tax benefits, persons connected with tax management should ensure compliance of all the pre-requisites, like procedures, rules etc. Besides, there should be constant monitoring, so that all the tax obligations are discharged and penal consequences avoided.

(f) Developing Tax effective Alternatives

A managerial decision could be assumed to have been well taken only if all the pros and cons are considered. A tax planner could guide important decisions, by considering varieties of alternatives and choices.

(g) Take advantage of variance allowances and deductions

A tax manager has to keep track of the provisions relating to various allowances, deductions, exemptions, and rebates so as to initiate tax planning measures. The details of various tax incentives have been duly dealt with in the relevant studies in this book.

OVERALL TAX PLANNING MEASURES

Apart from location and nature of business, form of organisation is another important area where tax planning with reference to setting up a new business could be exercised. It is discussed that, company form of organisation is to be preferred from long-term point of view. There are, however, certain other dimensions in this context. One such dimension is the preference for a widely held company as against a closely held company so much that we would suggest conversion of an existing closely held company into a widely held company because a widely held company would be able to enjoy the following tax benefits over a closely held company.

- (a) Widely-held companies do not find limitations and restrictions in the matter of set off and carry forward of losses whereas closely-held companies have certain limitations or restrictions in this respect under the provisions of Section 79 of the Act. In the case of companies in which the public are not substantially interested, losses will not be carried forward and set off unless: the shares of the company carrying not, less than 51 per cent of the voting power were beneficially held by the same person(s) both on the last day of the previous year in which loss occurred and on the last day of the previous year in which brought forward loss is sought to be set off.

However, if a change in voting power as aforesaid takes place consequent upon the death of a shareholder or on account of transfer of shares by way of gift to any relative of the shareholder making such gift, then the aforesaid disability does not get attracted. This disability is also not attracted where change in the shareholding of an Indian company which is a subsidiary of a foreign company, take place as a result of amalgamation or demerger of a foreign company subject to the condition that fifty one percent shareholders of the amalgamating or demerged foreign company continue to be the shareholders of the amalgamated or the resulting foreign company.

The provisions of Section 79 of the Act are applicable in the case of carry forward and set-off of losses only. As carry forward of unabsorbed depreciation allowance, investment allowance, development rebates and development allowance stands on an altogether different footing; their carry forward and set off is not governed by Section 79 of the Act in view of the decision of Madras High Court in CIT v. Concord Industries Ltd. (1979) 119 ITR 458 (Madras).

The Madras High Court's decision was later followed by the Kerala High Court in Commissioner of Income Tax v. Kalpaka Enterprises (P) Ltd. 986, 157 ITR 658 holding that Section 79 of the Income Tax Act, 1961 overrides the other provisions in Chapter VI and not the other provisions in the Act itself as is clear from the opening words 'Notwithstanding anything contained in this Chapter'. The connotation of the expression 'loss' occurring in Section 79 has thus to be understood in the context of the provisions contained in Chapter VI itself. The 'loss' mentioned in Section 79 is relatable to the 'loss' specifically

provided for in the other provisions of the said Chapter. It is in respect of losses which could be carried forward and set off under the said Chapter that Section 79 operates to limit that set off only to the previous year in question without extending it to any prior years. The Act does not treat or describe 'unabsorbed depreciation' or 'unabsorbed development rebate' as losses and these items cannot be treated as losses for purposes of Section 79. Hence, the bar imposed under Section 79 does not apply to 'unabsorbed depreciation' or 'unabsorbed development rebate'.

In this case, while finalising the assessment for the year 1969-70, the Income-tax Officer, after adjusting the losses brought forward from the preceding three years, determined the total income, as nil and also recorded *inter alia*, that unabsorbed depreciation for the prior years 1964-65 should be carried forward. The order of the income-tax Officer was set aside by the Commissioner in view of the fact that the officer had allowed set-off of the earlier year's losses against the profits of the year without considering the question of the applicability of Section 79 of the Act. The Tribunal, however, held that Section 79 of the Act did not apply to the unabsorbed depreciation and development rebate. On a reference to the High Court, the Court held that the Tribunal was right in holding that the provisions of Section 79 of the Act prohibiting the carry forward of losses in certain Companies would not apply to unabsorbed depreciation and development rebate.

- (b) The provisions of 'deemed dividend' in respect of advances or loans to shareholders, or any payment on behalf of shareholders or any payment for the individual benefit of a shareholder are applicable to closely held companies under Section 2(22)(e) of the Act.
- (c) The conversion would not be treated as transfer of ownership of the business and hence, there shall be no liability for capital-gains tax or Income tax in the hands of the closely-held company or the new widely-held company, due to conversion.

SOME GENERAL CONSIDERATIONS REGARDING NEW BUSINESS

1. *Separate Accounts*: It is advisable, though not a statutory obligation, to keep the accounts of the new business separate. This obviates the necessity of making any estimates, complicating the state of affairs of the new business. In this connection, reference may be made to *CIT v. Dunlop Rubber Co. (I) Ltd.*, 1977 (107 ITR 182).

In this case, the existing company established a new factory and no separate accounts were maintained by the new unit. But, as a matter of fact, this was not essential for claiming the benefit. In this case the assessee claimed the benefit on the proportion of turnover between the new unit and old unit. Was the method adopted correct? The duty of Revenue Department was to determine the exemption allowed by law.

It was held : "it was the duty of the I.T.O. under Sections 143 to 145 of the Act, to determine the total income of the assessee and determine the tax payable, even if the income could not be derived from the books of the assessee. So, Income-tax Officer cannot deny the relief. Difficulty in computing the relief cannot be a ground for rejecting the claim. A rule of apportionment consistent with commercial accounting must be evolved in computing the income. If the assessee already followed certain system, which is in vogue in general, from a commercial accounting angle, and if the Income-tax Officer disputes such system he should correct it and cannot reject it as whole-sum. In this case it was held that the Income-tax Officer could not refuse the claim for exemption.

Supreme Court in *Textile Machinery Corporation Ltd. v. Commissioner of Income-tax* (1977 108 ITR 195) *inter alia*, held that the fact that there was common management or the fact that separate accounts had not been maintained, would not lead to the conclusion that they were not separate undertakings. Even if separate account is not maintained, the investment in each of the units can be reasonably determined with the material which the assessee may make available to the department. The test is whether it is a new and identifiable undertaking separate and distinct from the existing business. It is sufficient if the new undertaking is an integrated unit by itself wherein articles are produced and a minimum of 10 persons are employed. In *Mahindra Sintered Products*

Ltd. (1989, 177, ITR 111), the Bombay High Court held that it was not necessary that separate accounts had to be maintained but separate accounts kept in the ledger are sufficient to claim deduction under Section 80J.

Following the ratio laid down by the Bombay High Court in the case of Mahindra Sintered Products Ltd. (supra) the Patna High Court held that the in order to claim special deduction under Section 80J, the following facts have to be established by the assessee namely:

- (i) investment of substantial fresh capital in the new industrial undertaking set up,
- (ii) employment of requisite labour therein,
- (iii) manufacture or production of articles on the said undertaking,
- (iv) earning of profits clearly attributable to the said undertaking, and
- (v) above all, a separate and distinct identity of the industrial unit set up.

The fact that there was common management or the fact that the separate accounts had not been maintained or that there was a common source of power would not mean that it was not a new undertaking. The assessee was held entitled for relief under Section 80J.

Following its judgement in the case of Mahindra Sintered Products Ltd. (supra) the Bombay High Court held in Commissioner of Income-tax v. Mazaggon Dock Ltd. (1991, 191 ITR 461) that the maintenance of separate accounts is not a condition precedent for claiming special deduction under Section 80J. Since the frigate project was a new one and the capital outlay was many times more than the assessee's capital, the assessee was entitled to deduction under Section 80J.

Though Section 80J is omitted with effect from 1.4.89, the ratio is applicable on other deduction available.

2. Avoid interconnection of service or departmental centralisation or pooling of resources of the new business and any other activity of the assessee. In this connection, a reference may be made to T. Satish U. Pai v. CIT 119 ITR 877 (Kar).

3. Avoid, transfer of goods between the new business and the assessee's other activities and encourage only cash flows out of sale proceeds towards investment or capital purpose.

4. It is better for the new business to have separate floor area, separate licenses and agreements, if it is not related to the assessee at all. Even separate profit computation should be encouraged. But the total income should be computed as per the scheme of the Act. [CIT v. Kashmir Fruit and Chemical Industries, 1975 98 ITR 311 (J & K)].

5. In case of capital intensive industries having long gestation periods; generally profit earning would be delayed. This is true even in the case of complicated and time-consuming manufacturing processes. In such circumstances, it is quite likely that only 'deficiency' would be absorbed.

6. Each industrial unit (for example, weaving and spinning units in case of textile business) of an industrial organisation has to be considered for computing the tax holiday benefit.

7. Any capital or revenue expenditure incurred towards scientific research under Section 35, will be treated as mentioned therein.

SETTING UP AND COMMENCEMENT OF BUSINESS VIS-A-VIS TAX PLANNING

Setting up a business within the scope of the Income Tax Act is a particular point to be considered for the purpose of tax planning strategy. It is different from the commencement of business. The company may be incurring certain expenditure of revenue nature during the intervening period after setting up and before the commencement of business (production). It is provided in the tax laws that the general expenses prior to the date of setting up are inadmissible but those incurred from the date of setting up and before the commencement of the business may be allowed as deduction for tax purposes provided they are of revenue nature and are incurred wholly and exclusively for the purpose of business.

From the decisions of the Bombay High Court in Western India Vegetable Products Ltd. v. CIT [(1954) 26 ITR 151 (Bom)] and the Supreme Court in CIT v. Ramaraju Surgical Cotton Mills Ltd. [(1967) 63 ITR 478 (SC)] and Travancore Cochin Chemical Pvt. Ltd. v. CIT [(1967) 65 ITR 651 (SC)], it has been well settled that a business is set up as soon as it is ready to commence production and it is not necessary that the actual production should be so commenced. It is also observed that the business commences with the start of first activity in point of time and which must necessarily precede other activity.

In the case of CIT v. Saurashtra Cement and Chemical Industries Ltd. [(1973) 91 ITR 170 (Guj.)], the decision of the Gujarat High Court is worth noting. In this case the company was established for manufacturing cement. The court observed that :

"the business is set up as soon as acquiring of lime stone is commenced even if at that time, the plant and machinery may not have been installed so that actual manufacturing operations may commence. They have expressed the view that the business commences with the start of activity which is first in point of time and which must necessarily precede other activities. The court observed that the business comprises several activities. Starting of one of those activities may in some circumstances fulfil the principal condition of setting up of a business. All the activities of the business need not be started simultaneously. But when an activity, which is the first in order of sequence preceding other activities is started, then it can be said that the company has been set up."

In the case of Commissioner of Income-tax v. Saurashtra Cement and Chemical Industries Ltd. (1973, 91 ITR 170) the Gujarat High court had, inter alia, held that 'Business' connoted a continuous course of activities. All the activities which go to make up the business need not be started simultaneously in order that the business may commence. The business would commence when the activity which is first in point of time and which must necessarily precede all other activities is started.

Reliance on the above case was placed by the Allahabad High Court in the case of Mod Industries Ltd. v. Commissioner of Income Tax (1977, 110 ITR 855) while deciding the question of allowance of business expenditure, it was held in this case that the foreign tour expenses of the chairman for setting up of two new factories were not - allowable as business expenditure under Section 37 and were of a capital nature.

The ruling of the Gujarat High Court was applied by it in the case of Hotel Alankar v. Commissioner of Income Tax (1982, 133 ITR 866) holding that when a business is established and is ready to commence business, it can be said of that business that it has been set up. The words 'ready to commence' would not necessarily mean that all the integrated activities are fully carried out and/or Wholly completed. This requirement is also complied with in a given case where an assessee had undertaken the first of the kind of integrated activities of which the business in overall comprised of, the question whether a business has been set-up or not is always a question of fact which has to be decided on the facts and in the circumstances of the case subject to the broad guidelines provided by different decisions in that behalf.

With regard to setting up of business or commencement of business, there is another decision of the Gujarat High Court in the case of Sarabhai Management Corporation Ltd. v. Commissioner of Income Tax (1976), 102 ITR 25 where it has held that, it is only after the business is setup that the previous year of that business commences and any expenses incurred prior to the setting up of a business would be of capital nature and not a permissible deduction. There may, however, be an interval between the setting up of the business and the commencement of the business, all expenses incurred during that interval would be a permissible deduction. Applying this decision, the Punjab and Haryana High Court in the case of Commissioner of Income-tax v. O.P. Khanna and Sons (1983, 140 ITR 558) (the assessee carried on business of printing press, purchased a new building in November 1970, installed electrical fittings and shifted to the building in Sept. 1971) held that during transitory period the building had been 'used' by the assessee and the depreciation allowance had to be made in respect of it while computing its business income.

The Gujarat High Courts' decision in the case of Sarabhai Management Corporation Ltd. (supra) had been

affirmed by the Supreme Court in *Commissioner of Income Tax v. Sarabhai Management Corporation Ltd.* (1991, 192 ITR 151) holding that even if the acquisition of the property for being let out could be said to be only the preparatory stage, the subsequent activities constituted activities in the course of the carrying on the assessee's business. It was not correct to treat the assessee as having commenced business only when the licensee or lessee occupied the premises or started paying rent. The High Court was held to be right in interfering with the finding of the Tribunal which was based on a mis-direction in law.

The Andhra Pradesh High Court laid down the following principles to determine whether a business has commenced or not in *Commissioner Income Tax v. Sponge Iron India Ltd.* (1993, 201 ITR 770):

Whether a business has commenced or not is a question of fact.

- (i) There is a distinction between the setting up of business and the commencement of business.
- (ii) Where the business consists of a continuous course of activities, for commencement of business all the activities which go to make up the business need not be started simultaneously. As soon as an activity which has the essential activity in the course of carrying on the business is started, the business must be said to have commenced.

In this case it was held, on facts, that since the business had not commenced, the interest income could not be treated as business income. It was also held that the assessee was not entitled to the deduction of the administrative expenses and exploration and mining expenses from out of its interest income.

Income pending setting up of business : It is possible that pending setting up of business the funds raised by a company may be invested temporarily so that they do not remain idle. Income from such investments is taxable under 'income from other sources'. Expenses pending setting up of business like salary to staff, office expenses etc. cannot be deducted from such investment income [*Traco Cable Co. Ltd. v. CIT* (1969) 72 ITR 503 (Ker.)]. Companies in such a scenario are in an unenviable position. On the one hand they are incurring expenses which go a begging and on the other, they have income from investments which are taxed. The Madras High Court in *CIT v. Seshasayee Paper & Boards Ltd.* (1985) 156 ITR 542 (Mad.)] held that set off under Section 72 of the Act is also not possible because the expenses on business if they are not allowable as a deduction, cannot assume the form of loss either so as to qualify for set off against income from investments. Companies may therefore expedite setting up of business so that the business loss may be set off against such income from other sources.

It may be noted that the view expounded by the Madras High Court in *Seshasayee* (supra) has been endorsed by the Supreme Court in *Tuticorin Alkale Chemicals & Fertilisers Ltd. v. CIT* (1997) 27 CLA 41. In a subsequent judgement *CIT v. Bokare Steel Ltd.* (1999) 33 CLA (Sur.) 18, however the Supreme Court has pointed out that where it is possible to establish a link between investment income pending commencement of business with the cost of project, the same can be reduced from the cost of assets it has in fact gone to subsidies.

LESSON ROUND UP

- "Tax Planning may be legitimate provided it is within the framework of the law. Colorable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honorable to avoid payment of tax by resorting to dubious methods."
- Tax planning, in fact, is an honest and rightful approach to the attainment of maximum benefits of the taxation laws within their framework.
- The basic objectives of tax planning are: (a) Reduction of tax liability (b) Minimisation of litigation (c) Productive investment (d) Healthy growth of economy (e) Economic stability.
- "Tax Avoidance" will be used to describe every attempt by legal means to prevent or reduce tax liability which would otherwise be incurred by taking advantage of some provisions or lack of provisions of law. It excludes fraud, concealment or other illegal measures.

- Tax evasion is a method of evading tax liability by dishonest means like suppression, showing lower incomes, conscious violation of rules, inflation of expenses etc.

SELF TEST QUESTION

These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation.

1. Explain the concept of tax planning and state its importance for a company.
2. (a) Explain the three methods by which an assessee can reduce his tax liability.
(b) Distinguish between tax evasion and tax avoidance?
3. Explain the two schools of thought on tax avoidance. Enumerate the general principles regarding tax avoidance.
4. What are the objectives of tax planning? Enumerate the requisites for its success.
5. Discuss in detail the areas where the tax planning can be resorted to by an assessee.
6. Compare the different forms of organisation from tax liability points of view.
7. Explain the significance of judicial pronouncements, notifications and circulars in the context of tax planning and outline the statutory force of notifications, circulars and rules framed by the Central Board for Direct Taxes.

SUGGESTED READINGS

1. Dr. V.K. Singhania : Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.
2. Girish Ahuja and Ravi Gupta : Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.
Professional Approach to Direct Taxes Law & Practice; Bharat Law House, New Delhi.
3. Dr. V.K. Singhania & Dr. Kapil Singhania : Direct Taxes Law & Practice; Taxmann Publications Pvt. Ltd., New Delhi.

Lesson 14

Wealth Tax Act, 1957

LESSON OUTLINE

- Charge of Tax
- Incidence of Wealth-tax
 - (1) In the case of an Individual
 - (2) Hindu Undivided Family
- Valuation Date [Section 2(q)]
- Tax Rate
- Net Wealth
 - (1) Computation of Net-wealth
 - (2) Assets
 - (3) Assets belonging to others but includable in the net-wealth of an individual
 - (4) Assets exempt from wealth-tax
 - (5) Debts and Liabilities
 - (6) Location of Assets and Debts
 - (7) Valuation of Assets
 - (8) Rounding off of net wealth
- Return of Wealth
- Assessment
- Liability to Assessment in Special Cases
- Payment and Recovery of Wealth-Tax
- Refunds (Section 34A)
- Rectification of Mistakes (Section 35)
- Settlement of Cases
- Appeals, Revisions and References
- Penalties under the Wealth-Tax Act
- Offences and Prosecutions (Sections 35A to 35N)
- Lesson Round Up
- Self Test Question

LEARNING OBJECTIVES

The Wealth Tax Act 1957 is basically tax on tangible property like real estate, jewellery and other personal effects. This lesson covers entire aspects of wealth tax starting from valuation of assets, rates, net wealth, Wealth Tax Return, Wealth Tax Assessment, payment mode, settlements, and penalties to offences and prosecutions. The Wealth tax is charged on the net wealth of an assessee. The rate to a particular assessee can be applied only when the following four ingredients are determined (a) The quantum of net wealth chargeable to tax under the Act; (b) Time aspect, i.e., net wealth on the valuation date; (c) Location of assets or place aspect; and (d) Ownership aspect, i.e., who is the owner of the wealth on the relevant valuation date.

At the end of this lesson, you will learn

- What is the basis of charge of wealth tax
- Who are not liable to pay wealth tax
- Which assets to be included in the wealth of a person
- How to value the assets
- Whether assets located outside India to be included in wealth
- What are the assessment procedure under wealth tax act
- What are the provisions of payment and recovery of wealth tax
- How to make an appeal before the appellate authority.
- Is there any penal provisions provided in the wealth tax act

Wealth tax shall be charged in respect of the net wealth on the corresponding valuation date of every individual, Hindu Undivided Family and company at the rate of one per cent of the amount by which the net wealth exceeds thirty lakh rupees.

INTRODUCTION

Wealth Tax in India is levied under Wealth Tax Act, 1957 on the net wealth of assessee and it extends to whole of India including the State of Jammu and Kashmir. The calculation of net wealth is to be done as per provisions of Wealth Tax Act, 1957. Wealth tax is a direct tax and is to be paid year after year on the same property on its market value, whether or not such property yields any income.

CHARGEABILITY

Chargeability to tax depends upon the nationality and residential status of the assessee same as the residential status for the purpose of the Income Tax Act. The Wealth Tax is charged for every assessment year in respect of the net wealth of the corresponding valuation date of every individual, Hindu Undivided Family, and company, @1% of the amount by which net wealth exceeds ₹ 30 lakh. By virtue of section 45 of Wealth Tax Act, 1957, no wealth tax is chargeable in respect of net wealth of the following persons:

1. any company registered under Section 25 of the Companies Act, 1956;
2. any cooperative society;
3. any social club;
4. any political party within the meaning of explanation to Section 13A of the Income-tax Act; and
5. any mutual fund within the meaning of Section 10(23D) of the Income-tax Act.
6. the Reserve Bank of India incorporated under the Reserve Bank of India Act, 1934.

DEFINITIONS

(i) Individual

1. As per section 3, the term individual includes –
 - (a) a natural person or human being;
 - (b) Hindu Deity or mutawalli of a wakf as a juristic individual;
 - (c) group of individuals, being trustees of a trust [Trustees of Gordhandas Govind Ram Family Charity Trust v. C.I.T. (1973) 88 ITR 47 (S.C.)];
 - (d) holder of an imitable estate;
 - (e) group of individuals like Mappilla Tarwards. [W.T.O. v. C.K. Mammed Kayi (1981) 129 ITR 307 (S.C.)].
 - (f) AOP, where the shares of the members are indeterminate or unknown.

(ii) Hindu Undivided Family

The expression Hindu Undivided family (HUF) has not been defined in the act and the expression Hindu Undivided Family must be construed in the sense in which it is understood under the Hindu Law [Surjit Lal Chhabda v. CIT 101 ITR 776 (SC)]. For the purpose of levy of wealth tax Act, Jain and Sikhs families are also covered under the term HUF [CWT v. Champa Kumari Singh (1972) 83 ITR 720 (SC)].

(iii) Company

The term 'company' is defined in Section 2(h) of the Wealth-tax Act, 1957. According to this section the term 'company' means the same as is defined in Section 2(17) of the Income-tax Act, 1961 which is given hereunder:

Company means:

- (i) any Indian company, or
- (ii) any body corporate incorporated by or under the laws of a country outside India, or
- (iii) any institution, association or body which is or was assessable or was assessed as a company for any assessment year under the Indian Income-tax Act, 1922, or which is or was assessable or was assessed under this Act as a company for any assessment year commencing on or before the 1st day of April, 1970, or
- (iv) any institution, association or body, whether incorporated or not and whether Indian or non-Indian, which is declared by general or special order of the Board to be a Company:

Provided that such institution, association or body shall be deemed to be a company only for such assessment year or assessment years whether commencing before the 1st day of April, 1971 or on or after that date as may be specified in the declaration.

Test Your Knowledge



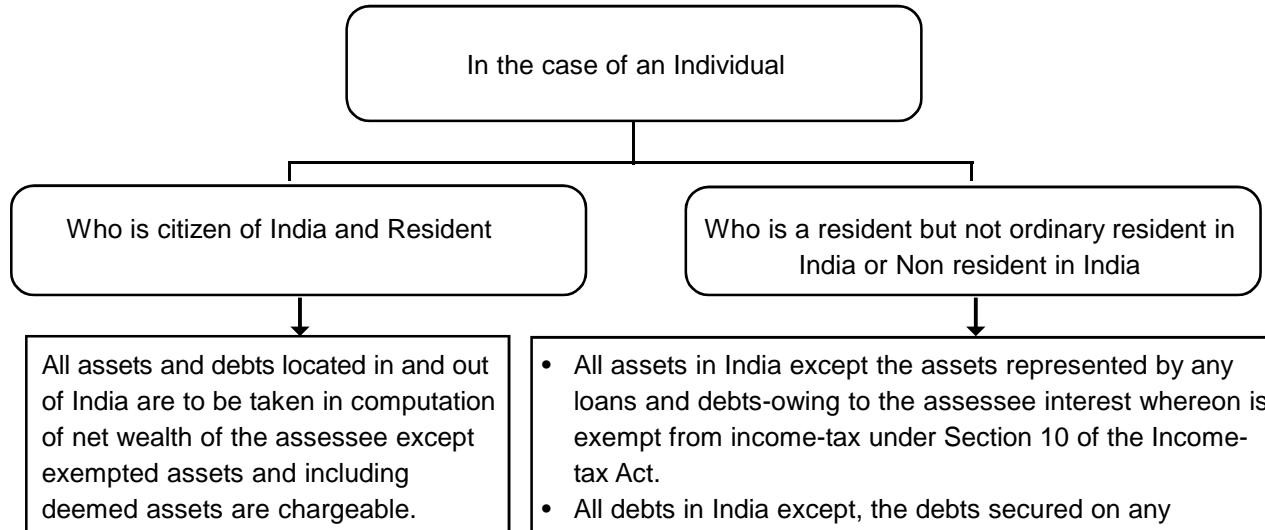
1. Which of the following person is not liable for wealth tax?

- (a) Cooperative society
- (b) Social club
- (c) Political party
- (d) Indian company
- (e) Institution or association

INCIDENCE OF WEALTH-TAX

The liability to wealth-tax depends upon the citizenship and residential status of an individual and in case of a Hindu undivided family upon its residential status alone. An individual or Hindu undivided family may be resident, not ordinarily resident or non-resident in India during the previous year ending on the valuation date. The residential status of an assessee is determined in the same manner as for income-tax purposes under the Income-tax Act.

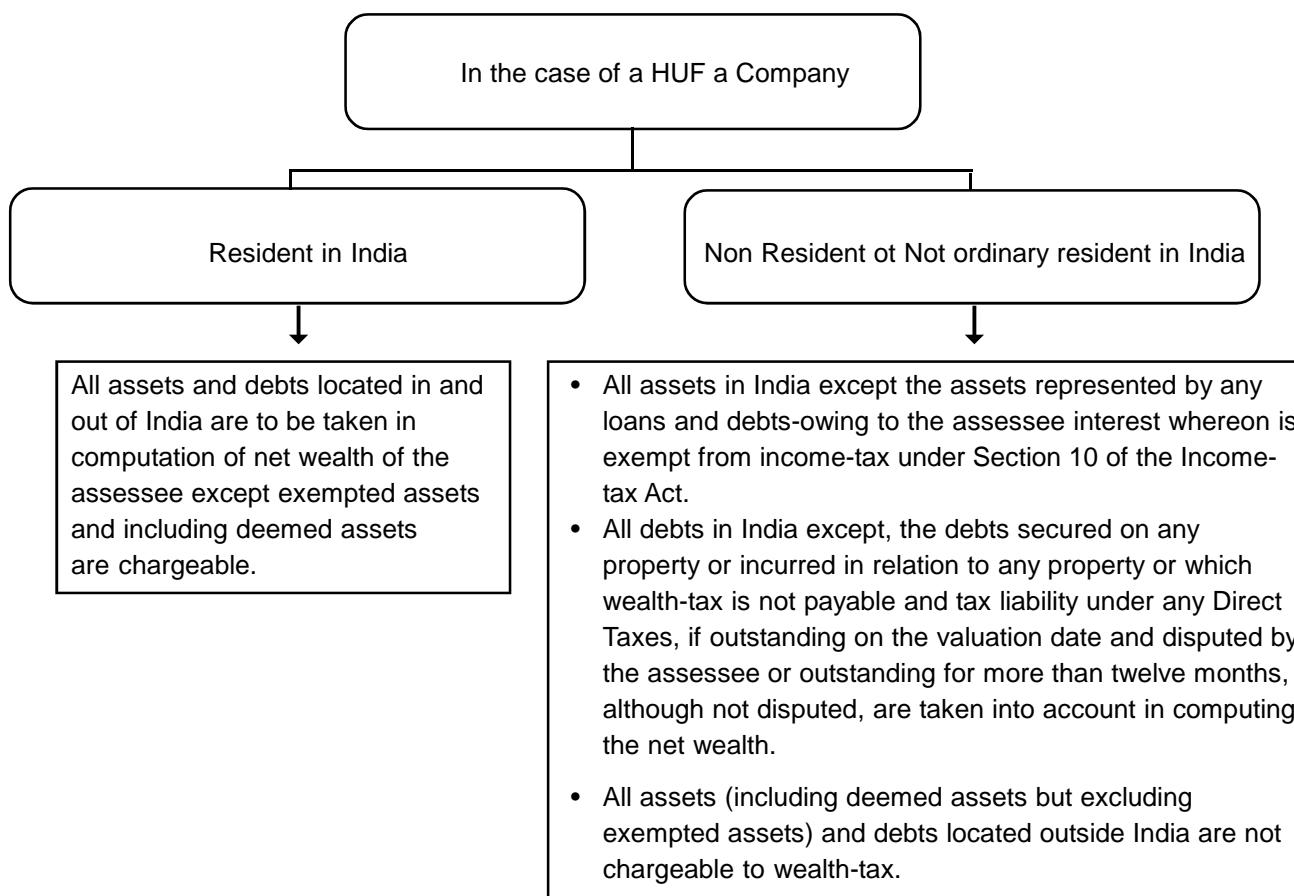
According to Section 6 of the Wealth-tax Act, 1957, the incidence to wealth-tax is as follows:



property or incurred in relation to any property or which wealth-tax is not payable and tax liability under any Direct Taxes, if outstanding on the valuation date and disputed by the assessee or outstanding for more than twelve months, although not disputed, are taken into account in computing the net wealth.

- All assets (including deemed assets but excluding exempted assets) and debts located outside India are not chargeable to wealth-tax.

By virtue of explanation 1A to Section 6 of the Wealth-tax Act the credit balance in a Non-resident (External) Account (interest thereon being exempt under Section 10 of the Income-tax Act), is not taxable in the case of "a person resident outside India" within the meaning of the Foreign Exchange Management Act, 1999.



VALUATION DATE [SECTION 2(q)]

Wealth-tax is levied on the net-wealth of a person as on a particular date, this date is known as the valuation date.

The valuation date for wealth-tax purposes is the last day of the previous year as defined in section 3 of Income Tax Act, 1961.

Moreover, valuation date is a continuous period starting at the first moment and ending at the last moment of a certain day (i.e. March 31 of the relevant previous year). Hence the net wealth tax shall be taken at the last moment of the valuation date [Banarsi Dass v. CWT (1970) 76 ITR (All)].

TAX RATES

With effect from the assessment year 2010-11 onwards, as per the amended Section 3, wealth-tax shall be charged in respect of the net wealth on the corresponding valuation date of every individual, Hindu Undivided Family and company at the rate of one per cent of the amount by which the net wealth exceeds thirty lakh rupees.

NET WEALTH [section 2(m)]

The concept of 'net-wealth' is very important for wealth-tax purposes because net wealth is the tax base. According to Section 2(m) "net-wealth" means the amount by which the aggregate value computed in accordance with the provisions of this Act of all the assets, wherever located, belonging to the assessee on the valuation date, including assets required to be included in his net wealth as on that date under this Act, is in excess of the aggregate value of all the debts owed by the assessee on the valuation date which have been incurred in relation to the said assets.

Computation of Net-Wealth

Net wealth shall be computed in the following manner:

Value of Assets u/s 2(ea) belong to the assessee as on valuation date	XXX
Add: Deemed assets under section 4	XXX
Less: Assets exempt u/s 5	XXX
Gross wealth	XXX
Less: Debts incurred in relation to the assets included in the net wealth	XXX
Net Wealth	XXX

While computing "net-wealth", the following assets are not includible in the net-wealth of an assessee:

- (i) Assets exempt under Section 5(1).
- (ii) Under Section 6, in case of an individual who is not a citizen of India or who is citizen of India but a non-resident or not ordinarily resident in India during the previous year and Hindu undivided family not resident or not ordinarily resident in India or a company not resident in India, the assets and debts situated outside India and loans and investments in India from foreign sources, interest on which is exempt from income-tax under Section 10 of the Income-tax Act.
- (iii) Assets lost, destroyed or stolen on or before the valuation date.

According to Section 2(ea) read with Section 2(m) of the Wealth-tax Act, the asset, to be chargeable to wealth-tax, must "belong" to the assessee on the relevant valuation date as the liability to wealth-tax arises out of ownership of the asset and not otherwise. In this connection, ownership includes deemed ownership.

The following persons having beneficial enjoyment of property are deemed as owner of immovable properties for the purpose of Section 2(m) of the Wealth-tax Act:

- a member of a co-operative society, company or other association of persons to whom a building or part thereof is allotted or leased under a house building scheme of the society, company or association, as the case may be.
- A person who has taken possession of any building under an agreement to sell (which is not registered) with the vendor and paid consideration or is willing to perform his part of contract [Section 53A of the Transfer of Property Act].

- A person who acquires any right (excluding any rights by way of a lease from month to month or for a period not exceeding one year) with respect to any building by virtue of any transaction as is referred in Section 269UA(f) of the Income-tax Act.

According to Section 2(m), all the assets owned by the assessee have to be taken into consideration, irrespective of the source from which he has acquired them. For instance, property received by him as a donee (from the donor) or as a devisee (according to the Will of a deceased testator), or as intestate heir of the deceased is to be reckoned. Likewise, property acquired with the help of borrowed money or with the assistance of some other person(s) has to be taken into account. It was on this principle that the Supreme Court rejected the contention of the Calcutta Electric Supply Corporation, that the service lines constructed at the cost of consumers, and not from its own funds, were not owned by it. It was held in this case that the only relevant thing for the purposes of the Wealth-tax Act was that the assessee should be the owner of the assets in question on the relevant valuation date. Since the balance sheet showed the service connections in question as 'assets', value thereof was not deductible in determining the net value of 'assets'. Mere possibility of confiscation does not impair ownership of the assessee in the articles seized. Hence, the value of the assets seized on the valuation date shall be included in the net-wealth. [Jayantilal Amritlal v. CWT (1982) 135 ITR 742 (Guj.)].

This is subject of course to the condition that the asset in question is one of the six specific assets mentioned in the exhaustive definition of 'assets' given in Section 2(ea).

ASSETS [SECTION 2(ea)]

The Finance Act, 1992 has amended the term assets with effect from the assessment year 1993-94 onwards. Accordingly, as per Section 2(ea) "assets" in relation to the assessment year commencing on the 1st day of April, 1993, or any subsequent assessment year, means:

- (i) House
- (ii) Motor Cars (other than those used by the assessee in the business of running them on hire or as stock-in-trade);
- (iii) Jewellery
- (iv) Yachts, boats and aircrafts (other than those used by the assessee for commercial purposes);
- (v) Urban land;
- (vi) Cash in hand, in excess of fifty thousand rupees, of individuals and Hindu undivided families and in the case of other persons any amount not recorded in the books of account.

(i) House:

1. The house means any building or land appurtenant thereto used for-
 - residential or commercial purposes
 - maintaining a guest house or
 - a farm house.
2. The house must be situated within twenty-five kilometers from local limits of any municipality/ Municipality Corporation or by any other name or a Cantonment Board.
3. The house will not include-
 - a house meant exclusively for residential purposes and which is allotted by a company to an employee or an officer or a director who is in whole-time employment, having a gross annual salary of less than ten lakh rupees;
 - any house for residential or commercial purposes which forms part of stock-in-trade;

- any house which the assessee may occupy for the purposes of any business or profession carried on by him;
- any residential property that has been let-out for a minimum period of three hundred (300) days in the previous year;
- any property in the nature of commercial establishments or complexes;

(ii) Motor Car

All motor cars whether Indian or Foreign (other than those used by the assessee in the business of running them on hire or as stock-in-trade);

(iii) Jewellery

- (1) Jewellery includes any jewellery, bullion, furniture, utensils or any other article made wholly or partly of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals (other than those held by the assessee as stock-in-trade);
- (2) It also includes - (i) ornaments made of gold, silver, platinum or any other precious metal or any alloy containing one or more of such precious metals, whether or not containing any precious or semi-precious stones, and whether or not worked or sewn into any wearing apparel; (ii) precious or semi-precious stones, whether or not set in any furniture, utensils or other article or worked or sewn into any wearing apparel;
- (3) And does not include: The Gold Deposit Bonds issued under the Gold Deposit Scheme, 1999 notified by the Central Government.

(iv) Yachts, boats and aircrafts (other than those used by the assessee for commercial purposes);

(v) Urban land

1. The urban land means land situated in any area which is comprised within the jurisdiction of a municipality (whether known as a municipality, municipal corporation, notified area committee, town area committee, town committee, or by any other name) or a cantonment board And which has a population of not less than ten thousand according to the last preceding census of which the relevant figures have been published before the valuation date or not being 2 km from the local limits of any municipality and which has a population of more than 10,000 and upto 1 lakh or not more than 6 km, from the local limits of any municipality having more than 1 lakh or upto 10 lakh or not being more than 8 km, from the local limits of any municipality having population of more than 10 lakh
2. The urban land means any area located within eight kilometers from the local limits of any municipality (whether known as a municipality, municipal corporation, notified area committee, town area committee, town committee, or by any other name) or a cantonment board but does not include:
 - But does not include land classified as agricultural land in the records of the government and used for agricultural purposes or land on which construction of a building is not permissible under any law for the time being in force in the area in which such land is situated or
 - the land occupied by any building which has been constructed with the approval of the appropriate authority or
 - any unused land held by the assessee for industrial purposes for a period of two years from the date of its acquisition by him or
 - any land held by the assessee as stock-in-trade for a period of five years from the date of its acquisition by him.

(vi) Cash in hand

Cash in hand, in excess of fifty thousand rupees, of individuals and Hindu Undivided families and in the case of other persons any amount not recorded in the books of account.

ASSETS BELONGING TO OTHERS BUT INCLUDIBLE IN THE NET-WEALTH OF AN INDIVIDUAL (DEEMED ASSETS) SECTION 4

Ordinarily, in computing the net wealth of an assessee, only the assets which belong to him on valuation date are taken into account. However, to reduce the liability to wealth-tax, an individual may transfer his assets without adequate consideration to his spouse, son's wife, AOP etc.

Clauses (i) to (vi) of Section 4(1)(a); Section 4(1)(b) and Sub-sections (1A), (5A) and (7) foil an attempt on the part of propertied persons to evade or to lessen their due burden of wealth-tax by the device of transferring their property in whole or in part to their spouse or son's wife or, after December 31, 1969, converting it into the property of family, or after 1.6.1973 to their daughter-in-law. Further, w.e.f. 1.4.1980 the gift of property made by the individual to his H.U.F. is also counteracted by amending Section 4(1A). Gifts made by book entries are also includible in the donor's taxable wealth unless he proves to the satisfaction of the Wealth-tax Officer that the money was actually delivered. Thus, the Section extends the gamut of net wealth in respect of an individual regarding certain assets transferred to the spouse or to association of persons for the benefit of individual, his or her spouse or converted into the property belonging to the Hindu undivided family of which he is a member and such assets shall be deemed as belonging to the individual for being assessable in his hands, subject to satisfaction of the following conditions:

- (a) The individual must be the owner of these assets.
- (b) These assets must be transferred without adequate consideration.
- (c) These assets must be held by the transferee on the valuation date. If the asset has been spent, lost or destroyed before the valuation date, the value of such asset shall not be included in the net-wealth of the individual. If the form of assets transferred is changed before the valuation date, the substituted assets shall be included in the net-wealth of the individual. If the substituted asset is one which is exempt from wealth-tax, it shall not be included in the net-wealth of the transferor. Further, if any debt is incurred on the transferred assets by the transferee, and which is payable on the valuation date, it shall be deducted from the value of the transferred assets.

According to Section 4, the following transfers shall be included in the net-wealth of an assessee:

(1) Assets transferred to spouse [Section 4(1)(a)(i)]

Assets transferred by an individual to his or her spouse directly or indirectly, otherwise than for adequate consideration or in connection with an agreement to live apart.

In this connection the following points are important:

- (a) The asset must be transferred to spouse, i.e., a person who is lawfully wedded and the relationship of spouse must exist on the two dates namely, the date of transfer and the valuation date.

Thus, if the transferor and the transferee were not in the relation of husband and wife on the date of the transfer, but they had merely entered into an agreement to marry, a mere alliance, such a transaction would not attract this clause. Again a divorce terminates the legal relationship between spouses and, therefore, the transfer between the divorced husband and wife would not be affected by the present sub-clause. The existence of relationship is necessary not only on the date of transfer but also on the valuation date. Thus, if transfer is effected before the marriage is solemnised, or, although the transfer is effected during subsistence of marriage, but on the valuation date such relationship is terminated, then in both the cases, the value of assets cannot be included in the net-wealth of the transferor.

- (b) The asset may be transferred directly or indirectly by an individual to the spouse. A direct transfer may be by handing over certain assets to the spouse or by regular deed of conveyance. An indirect transfer may be through a trust or by a cross-transfer.

Thus, if X and Y are father and son, and X transfers certain assets to his daughter-in-law and, in return, therefof, Y transfers his property to his mother, it would really be a case of both X and Y adopting circuitous method to evade tax. In such a case, the veil would be pierced through to expose the real character of the so-called independent transactions and both X and Y would be subject to the operation of this clause [CIT v. C.M. Kothari (1963) 49 ITR 107 SC].

- (c) The asset must be transferred without adequate consideration. Love and affection may be a good consideration but it is not adequate consideration. 'Adequate consideration'; means something more than valid consideration. It must be construed as valuable consideration capable of being compared and measured with money or money's worth. If the property has been transferred without adequate consideration, the difference between the adequate consideration and inadequate consideration shall be included in the net-wealth of transferor.
- (d) If the asset has been transferred under an agreement that husband and wife shall live apart and the agreement is genuine and not sham, the value of the asset transferred shall not be included in the net-wealth of the transferor. The phrase "to live separately" is of wider connotation and even the voluntary agreements to live apart fall within it.

The arrangement in connection with an agreement to live apart may be in both ways. A husband might give his wife moneys for her living apart and similarly the wife may give moneys to her husband for his consent to live apart.

(2) Assets held by minor child [Section 4(1)(a)(ii)]

Assets held by a minor child (not being minor married daughter) of such individual.

The word 'child' means a legitimate child or a step child or adopted child but does not include an illegitimate child or grand child or child of any other relative.

The child must be minor on two dates, i.e., the date of transfer and the valuation date. If the child attains majority before the valuation date, the value of the asset held by such child shall not be included in the net-wealth of the assessee.

However, such assets as have been acquired by the minor child out of his income referred to in the proviso to Section 64(1A) of the Income-tax Act (i.e. such income as accrues or arises to the minor child on account of any manual work done by him or any activity involving application of his skill, talent or specialised knowledge, experience etc.) and which are held by him on the valuation date are not be included in computing the net wealth of such individual.

Further, where the assets held by the minor child are to be clubbed with that of his parents, the following rule shall apply:

- (a) where the marriage of his parents subsists, in the net wealth of that parent whose net wealth (excluding the assets of the minor child so includable under this sub-section) is greater; or
- (b) where the marriage of his parents does not subsist, in the net wealth of that parent who maintains the minor child in the previous year,

and where any such assets are once included in the net wealth of either parent, they will not be included in the net wealth of the other parent unless the Assessing Officer is satisfied after giving that parent an opportunity of being heard that it is necessary so to do.

(3) Assets transferred to a person or association of persons [Section 4(1)(a)(iii)]

Assets transferred by an individual to a person or association of persons after 31.3.56 directly or indirectly, otherwise than for adequate consideration for the immediate or deferred benefit of the transferor, his or her spouse are to be included in net-wealth of the transferor. Here it is important to note that the beneficiary can

enjoy either the asset as such or the income of property transferred. Further, in the case of deriving of benefits by the 'spouse', relationship of husband and wife between the transferor and beneficiary must exist on the valuation date. Otherwise, the value of the assets transferred shall not be included in the net-wealth of transferor.

However, assets transferred to trust in respect of which gift-tax is chargeable are not includable in computing net wealth of donor - CWT v. H.H. Bhawanisingh (1989) 89 CTR (MP) 134.

(4) Assets transferred under revocable transfers [Section 4(1)(a)(iv)]

Assets transferred under revocable transfers [Section 4(1)(a)(iv)] are included in the net wealth of the transferor. For this purpose, the following transactions are treated as revocable transfers [Clause (b) of Explanation to Section 4]:

- (i) transfer revocable within a period of six years or during the transferee's lifetime; or
- (ii) if the transferor derives any benefit, directly or indirectly, from the assets transferred; or
- (iii) if the transferor has a right to re-transfer, directly or indirectly, in respect of the whole or any part of the assets or income from the assets to be transferred; or
- (iv) if the transferor has the right to re-assume power, directly or indirectly, over the whole or any part of the assets or income from the assets so transferred.

Where a trust is revocable by the donor after ten years, it is irrevocable. [CWT v. Sardar Surjit Singh (1982) 138 ITR 186 (Cal.)].

The property transferred under irrevocable transfer shall be included in the net wealth of the transferor, when he gets the right to revoke the transfer even if he does not revoke the transfer.

Here it must be noted that the irrevocable transfer should not be for the benefit of spouse or minor child of the transferor. It must be for the 'benefit' of a person other than spouse or minor child of the transferor.

Assets transferred under points (1) to (4) described hereinabove shall not be included in the net-wealth of an individual for any assessment year commencing after 31.3.1964, but before 1.4.1972, if:

- (a) the transfer of such assets or any part thereof is chargeable to gift-tax under the Gift-tax Act, 1958, or
- (b) the transfer of such assets is exempt under Section 5 of the Gift-tax Act.

From this, it follows that the gifts made prior to the previous year 1963-64 or made after 31.3.1972 shall be chargeable to Wealth-tax under the Wealth-tax Act, 1957, notwithstanding the fact that such gifts have also been chargeable to gift-tax or exempted under Section 5 of the Gift-tax Act.

(5) Assets transferred by an individual to son's wife or son's minor child including step child and adopted child [Section 4(1)(a)(v)]

Assets held by son's wife to whom such assets have been transferred by the individual directly or indirectly on or after 1.6.1973, otherwise than for adequate consideration shall be included in the net wealth of the assessee for wealth-tax purposes. [CWT v. Sushiladevi (1998) 232 ITR 556 (MP)].

(6) Assets transferred by an individual for the benefits of son's wife [Section 4(1)(a)(vi)]

Directly or indirectly, assets transferred on or after 1.6.1973 without adequate consideration, to a person or an association of persons for the immediate or deferred benefits of the son's wife are deemed to be the assets of the assessee.

(7) Interest in the assets of the firm, etc. [Section 4(1)(b)]

The value of the partner's interest in the assets of the firm includable in the net wealth, shall be determined in the manner laid down in Schedule III. Where a minor is admitted to the benefits of partnership in a firm, the value of

such minor's interest, determined as per Schedule III shall be included where the marriage of the parents subsists in the net wealth of that parent of the minor whose net wealth (excluding the minor's interest) is greater. Once such interest is included in the net wealth of either parent for any assessment year, the same shall not be included in the net wealth of the other parent unless the Assessing Officer is satisfied, after giving that parent an opportunity of being heard, that it is necessary so to do.

In case the marriage of his parents does not subsist, the value of such minor's interest in the assets of the firm shall be included in the net wealth of that parent who maintains the minor child in the previous year.

(8) Converted Property [Section 4(1A)]

Where an individual who is a member of a Hindu undivided family, converts his individual property after 31.12.69 into property belonging to the family through the act of impressing such separate property with the character of property belonging to the family or throwing it into the common stock of the family, such property is known as converted property and the value of such converted property or any part thereof on the valuation date shall be included in the net-wealth of the individual. Further, any gift made by a member of a HUF, of a separate property or any transfer of property otherwise than for adequate consideration to the family has also to be included in the net-wealth of the individual.

Where the converted property is the subject-matter of partition subsequently amongst the members of the family, the converted property or any part thereof received by the spouse of the individual on such partition shall be deemed to be assets transferred by the individual indirectly to the spouse and the value of such assets shall be included in his net-wealth.

The property, on being included in the net-wealth of the individual, shall be excluded from the net-wealth of the family or spouse as the case may be.

Test your knowledge



2. Which of the following transactions can be treated as revocable transfers?

- (a) If the transferor derives any benefit, directly or indirectly.
- (b) If the transferor has the right to transfer as gift directly or indirectly.
- (c) If the transferor has the right to re-assume power, directly or indirectly.
- (d) If the transferor has a right to re-transfer, directly or indirectly.
- (e) If the transferor transfers within a period of five years.

(9) Transfer by means of entries in the books [Section 4(5A)]

Where a gift of money from one person to another is made by means of entries in the books of account maintained by any one or more of the following persons:

- (a) the donor;
- (b) an individual with whom the donor has business or other relationship; and
- (c) a Hindu undivided family or a firm or an association of persons or body of individuals with which the donor has business connection, the amounts so gifted shall be included in the net wealth of the donor. However, if the donor can prove to the satisfaction of the Wealth-tax Officer that simultaneous to the making of the book entry, money is actually handed over to the donee in the physical sense, the money so gifted shall not be included in the net-wealth of the donor.

(10) Impartible estate [Section 4(6)]

Although under the general law the Hindu undivided family is the owner of the properties in an impartible estate, for the purpose of Wealth Tax Act, the holder is deemed to be the individual owner of that estate and accordingly liable to include the value of all properties comprised in the estate in his individual net- wealth.

(11) House from a co-operative housing society [Section 4(7)]

Where the assessee is a member of a co-operative housing society and a building or part thereof is allotted or leased to him under a house building scheme of the society, the assessee shall be deemed to be the owner of such building or part thereof and the value of such building shall be included in the net-wealth of the assessee. For determining the value of such building, any outstanding amount payable by the assessee to the society towards the cost of such building or part thereof and the land appurtenant thereto shall be deducted as a debt owed by him in relation to such building.

While including the above assets under Section 4, the following points must be considered:

- (a) The asset need not be in the same form in which it was transferred by the transferor.
- (b) Though Section 4 covers 'direct' and 'indirect' transfers, accretions to the assets transferred do not come within the scope of Section 4. Hence, as held in the case of *CWT v. Saraswathi Achi* (1980) 4 Taxman 356 (Mad.) though the value of equity shares gifted by an assessee to his wife is taxable in his hands, value of bonus shares allotted to wife is not includable as an asset of the donor.
- (c) The phrase 'individual' has to be interpreted to mean both man and woman.

ASSETS EXEMPT FROM WEALTH-TAX

Under Section 5, wealth-tax shall not be payable by an assessee in respect of the following assets and such assets shall not be included in the net wealth of the assessee.

(i) Property held under a Trust [Section 5(1)(i)]

Any property held by the assessee under a trust or other legal obligation for any public purpose of a charitable or religious nature in India.

For exemption under this clause three conditions must be satisfied:

- (a) The property must be held by him under a trust or other legal obligation for the stated purposes. However, the property of the trust should not be used for the benefit of the donor or the family members of such person.
- (b) The property must be for a public charitable purpose or a public religious purpose. The expression "charitable purpose" means relief of the poor, educational or medical relief or the advancement of any other object of general public utility, and "religious purpose" means any purpose related to the advancement, support or propagation of religion.
- (c) The property of the trust must be used in India. If the trust is situated in India but the property is used outside India, the property shall not be exempt from tax.

In a case where the deed did not provide specifically that the income of the trust should be spent in India but there was nothing on record to show that any part of the income was spent outside India, it was held that the exemption cannot be denied. [*Trustees of H.E.H. The Nizam's Sahebzadas of Sarf-E-Khas Trust v. C.W.T.* (1981) 127 ITR 694 (A.P.)].

By virtue of amendment of Section 5(1)(i) from the assessment year 1986-87, exemption from wealth-tax in respect of business assets of public charitable or religious trusts and institutions has been withdrawn. Consequently, w.e.f. assessment year 1986-87, only the following assets, as provided in the Income-tax Act will be exempt from wealth-tax:

- (a) where the trust carried on business wholly for public religious purposes and the business consists of: (i) printing and publication of books; or (ii) publication of books; or (iii) is of a kind notified by the Central Government in this behalf in the Official Gazette.
- (b) the business is carried on by an institution wholly for charitable purposes and the work in connection with the business is carried on mainly for the beneficiaries of the institution; and separate books of account are maintained by the trust or institution in respect of such business.
- (c) an institution, fund or trust referred to in clause (22) or (22A) or (23B) or (23C) of Section 10 of the Income-tax Act carries on the business.

However, exemption in respect of property forming part of business of an educational institution or a hospital entitled to exemption under Section 10 (22)/10(22A) of the Income-tax Act, would be available, only if such institution satisfy conditions of Section 11(4A) of the Income-tax Act.

(ii) Interest in the coparcenary property of the HUF [Section 5(1)(ii)]

The interest of the assessee in the coparcenary property of any H.U.F. of which he is a member. However, on this property the family is liable to pay tax. This exemption is available to the assessee only so long as the property remains joint and he continues as a member of that family. As soon as a partition is effected, the share allocated to a member becomes his personal property and after that he would be liable to pay tax on his share.

(iii) One official residence of the Ruler [Section 5(1)(iii)]

As per Section 5(1)(iii), any one building in the occupation of a former ruler of a princely state which has been declared by the Central Government as his official residence immediately before the commencement of the Constitution (Twenty Sixth Amendment) Act, 1971. If a Ruler has several official residences, out of them exemption is available in respect of one alone. The choice of this one residence was left to the Ruler, who accordingly conveyed his option to the Board. Further, the exemption of building in full value can be enjoyed by the Ruler during his life time. After the death of the Ruler the successor cannot enjoy the benefit of the exemption. It must be noted that the exemption is granted only in respect of those buildings or places which were occupied by the Ruler and not in respect of buildings let-out to tenants - Mohd. Ali Khan v. CWT (1983) 12 Taxman 330 (Delhi).

(iv) Hireloom Jewellery of an earstwhile ruler [Section 5(1)(iv)]

Jewellery in the possession of any Ruler (excluding his personal property) which has been recognised before the commencement of the Wealth-tax Act, by the Central Government, as his heirloom or by the Central Board of Direct Taxes, hereinafter referred to as "Board" as his heirloom at the time of his first assessment to wealth-tax under Wealth-tax Act. The recognition of the jewellery shall be subject to the following conditions:

- (a) that the jewellery shall be permanently kept in India and shall not be removed outside India except for a purpose and period approved by the Board;
- (b) that reasonable steps shall be taken for keeping jewellery substantially in its original shape;
- (c) that reasonable facilities shall be allowed to the authorised person to examine the jewellery as and when necessary.

If the assessee fails to fulfil any of the above conditions, the Board after recording the reasons in writing, may withdraw retrospectively with effect from the date of commencement of the Rulers of Indian States (Abolition of Privileges) Act, 1972 and wealth-tax shall become payable by the assessee for all the assessment years for which the jewellery was exempted on account of the recognition. However, the wealth-tax payable on the valuation date relevant to the assessment year in which the recognition was withdrawn shall not exceed 50 per cent of the fair market value of such jewellery.

(v) Money and the assets brought into India by Citizen of India or person of India Origin [Section 5(1)(v)]

An assessee being a person of Indian origin or a citizen of India who was ordinarily residing in a foreign country and who, on leaving such country, has returned to India with the intention of permanently residing therein, moneys and the value of assets brought by him into India and the value of the assets acquired by him out of such money. (Within one year immediately preceding the date of his return and at any time thereafter). However, this exemption shall be available for a period of 7 successive assessment years commencing with the assessment year next following the date on which such person returned in India.

For the purpose of this clause, a person shall be deemed to be of Indian origin if he or either of his parents or any of his grand-parents, was born in undivided India. Moneys standing to the credit of such persons, in a Non-resident (External) Account in any bank in India in accordance with the Foreign Exchange Management Act, 1999, and any rules made thereunder, on the date of his return to India, shall be deemed to be moneys brought by him into India on that date.

(vi) One House or part of the house [Section 5(1)(vi)]

One house or part of a house belonging to an individual or a Hindu Undivided Family; or a plot of land comprising an area of five hundred square meters or less.

A cinema hall cannot be treated as a house as per Section 5(vi), as was decided in the case CIT v. Jai Kishen Gupta (2004) 137 Taxman 388 (All.).

Illustration

How would you treat the following items under the Wealth Tax Act?

1. Mr. Dandona is a managing trustee of an educational society. The society is a public charitable trust. The value of trust property is ₹ 50 Lacs, which is held by Mr. Dandona in his name as Managing director.
2. Mr. G, an Indian repatriate came to India on 1st Oct' 2012, The balance in his non resident external account is ₹ 10 Lacs on that day, out of which he purchased a car for ₹ 4 Lacs.
3. Mr. X is a former ruler; his Jewellery was recognized by Central Govt. as his heirloom in 1956.
4. Interest of Mr. Z in the HUP to which he is a member.
5. Mr. Krishan owns only one house valued at ₹ 12 Lacs, the house has been build on a land area of 450 sq. meter.

Solution

1. Any property held by assessee under trust for any public purposes of charitable nature in India is exempt u/s 5(1)(i), hence value of trust property is neither includable in the wealth of Mr. Dandona nor the society is liable to pay wealth tax on it.
2. Balance on Non-resident external account is exempt u/s 5 (v), Further Car acquired by him out of that balance is also exempt.
3. Jewellery in procession of a former ruler that has been recognized as an heirloom by central govt. is exempt u/s 5 (iv).
4. As Mr. Z is a member of HUF so his interest in family property is totally exempt from tax u/s 5 (ii)
5. Since the land area does not exceed 500 sq. meters. Thus the value of house is exempt from wealth tax as value of one house is exempt u/s 5(vi)

Illustration

Mahan Ltd. owns following assets. State whether these assets are chargeable to wealth tax for assessment year 2014-2015

- (a) Stock in trade
- (b) Residential flats given to employees by the company with annual salary of ₹ 8,00,000 each
- (c) Shares in Indian Companies.
- (d) Cars used by directors for company's business purpose.
- (e) Land acquired in 1992 on which construction of building is not permitted.

Solution

- (a) Stock in trade is not an asset under section 2(ea).
- (b) Since the residential flats have been given to the employees with annual salary of less than ₹ 10,00,000, so these are not to be treated as assets under section 2(ea)(i).
- (c) Shares in Indian companies are not treated as assets under section 2(ea).
- (d) Since cars are not being used by the assessee for the business of running them on hire or being held as stock-in-trade, hence cars are to be treated as assets under Section [2(ea)(ii)].
- (e) Since the construction of the building is not permitted on the land hence it is not to be treated as asset under section [2(ea)(v)]

Illustration

Discuss whether the following are assets:

- (a) A residential house property given on rent by Mr. Vidhu for a period of 305 day;
- (b) A commercial house property used by Mr. Y for his business purposes.
- (c) Mr. Sinha was having cash of ₹ 1,20,000 on 31st March 2013, out of which he deposited ₹ 40,000 in bank on the same day.
- (d) Aircrafts owned by Tom and Jerry airlines.
- (e) Amount held by Mr. Z in fixed deposits in bank.

Solution

- (a) Since the residential house or property has been given for rent on more than 300 days in previous year, hence it is not be treated as an asset under section [2(ea)(i)].
- (b) Since commercial house or property is being used by assessee for his own business purposes hence it is not be treated as an asset.
- (c) Since on the last moment of valuation date i.e. 31st March 2013, Mr. Sinha is having cash of ₹ 80,000 and out of which ₹ 50,000 is not an asset under section [2(ea)(vi)], thus remaining ₹ 30,000 is taken as an asset.
- (d) Under section 2(ea)(iv) aircrafts used by assessee for commercial purposes is not an asset.
- (e) Amount held by Mr. Z in fixed deposit is not an asset under section 2(ea).

DEBTS AND LIABILITIES**What is debt ?**

The word debt is not defined under the Act. But in the very nature of things, the deductible debt or liability must be "external" to the concerned assessee that is to say in favour of other persons, or parties. In other words, from

the "liabilities side" of his Balance Sheet, his own capital, reserves and the profit and loss a/c credit balance etc., must be ignored altogether.

In order to compute the net-wealth of the assessee, the aggregate value of the debts and liabilities which are legally enforceable against him on the valuation date must be deducted from the aggregate value of the assets. Further, the liabilities which have matured into debts payable at present or in future are deductible.

The most important thing of course is that the debt or liability in question must have been incurred specifically in relation to the taxable asset. While bank overdraft taken for meeting the working capital requirements will therefore not be deductible.

In computation of the net wealth of an assessee under section 2(m), any debt secured on the security of an asset which is entirely and completely excluded in computation of wealth tax shall not be deducted. When a debt is secured on several items of properties one of which alone is exempted, that portion of the debt which attributable to the value of the property exempted from wealth tax can not be deducted in the computation of the net wealth of the assessee [CIT v. Vaidyanathan (K.S) (1985) 153 ITR 11 (Mad)]

The following debts are not deductible:

- (i) Debts located outside India, in case of non-citizens of India and an individual or a Hindu Undivided Family who is a non-resident or not ordinarily resident in India. These debts are not taken into account because in these cases the assets located outside India are also to be ignored.
- (ii) Debts secured on or incurred in relation to the non-taxable assets i.e. assets for which exemption is available under Section 5 or assets which do not fall within the definition of the term in Section 2(ea).

LOCATION OF ASSETS AND DEBTS

The determination of location of assets and debts is necessary for the following three reasons:

- (i) The assets and debts located outside India and belonging to non-citizens are not included in the net-wealth.
- (ii) Payment of tax may be held in abeyance where the assets taken into account for assessment are located outside India in cases where the laws of that country prohibit or restrict the remittance of money to India.
- (iii) Tax rebate is granted to an individual and a H.U.F. in respect of their assets located outside India.

Though the question as to where an assets is located is essentially one of fact and will have to be determined in the light of evidence, guidelines, as follows, may be used for the purpose:

- (a) Tangible Immovable Property: The location of the tangible immovable property (land, buildings, lakes, etc.) is in India, if it is physically situated in India.
- (b) Intangible Immovable Property: Rights or interest in or over immovable property (otherwise than by way of security) or benefits arising out of immovable property are located in India if the immovable property to which the rights are attached or out of which the benefits arise, lies in India.

Examples of rights and interests are easements of light and air, right of way, ferry, right of fishery, etc.

Examples of benefits arising out of immovable property are: right to collect market dues at a fair held on a plot of land; right to levy tolls; right to use water of a lake or tank for irrigation; right to collect lac from trees; etc.

- (c) Movable Property: Right or interests (otherwise than by way of security) in or over tangible movable property are located in India if such property is located in India.

However, the supreme Court has held that the goods on high seas, while in transit to India, are located outside India, since the high seas cannot be considered as a part of India in the absence of anything in the Act making a part of India [C.W.T. v. Consolidated Pneumatic Tools Co. Ltd. (1971) 81 ITR 752].

- (d) Debts: Debts, secured or unsecured are located in India if they are contracted to be repaid in India and where the place of repayment is not specified, if the debtor is residing in India. The circumstance that the documentary evidence of the debt is situated in a country different from the country of residence of the debtor is immaterial.
- (e) Ship or Air Crafts: They are located in India if they are registered in India.

For assets which are covered by the above items, the location shall be determined having regard to the nature of the assets.

VALUATION OF ASSETS

Wealth-tax is charged on the net-wealth of the assessee, therefore, it is an important function of the Assessing Officer to determine the value of the assets held by the assessee on the valuation date. Section 7 lays down the method of its determination, the value of any asset, other than cash, shall be the value thereof determined in the manner laid down in Schedule III.

(A) VALUATION OF IMMOVABLE PROPERTY

The valuation of immovable property is given in Part B of Schedule III of the Wealth tax Act.

Steps for Valuation of immovable property:

1. Determine annual rent.
2. Calculate Gross maintainable rent.
3. Calculate Net Maintainable Rent.
4. Capitalise Net Maintainable Rent as per the given formula in Rule 3.
5. Now make adjustments for unbuilt area of plot of land
6. Then adjust for unearned increase in the value of the land.
7. At last compare the value derived with actual cost of construction as given below in (g) to determine the value to be taken for wealth tax purpose.

(a) Determination of Annual Rent:

Annual Rent is equal to: Actual rent received or receivable (including all payments /benefits/perquisites paid by the tenant for the use of the property in any form or name) (if property is let out throughout the year ending on the valuation date)

Or

Actual rent received or receivable (including all payments /benefits/perquisites paid by the tenant for the use of the property in any form or name) \times 12 Number of Months for which the property is let out (if property is let for only a part of the year ending on the valuation date)

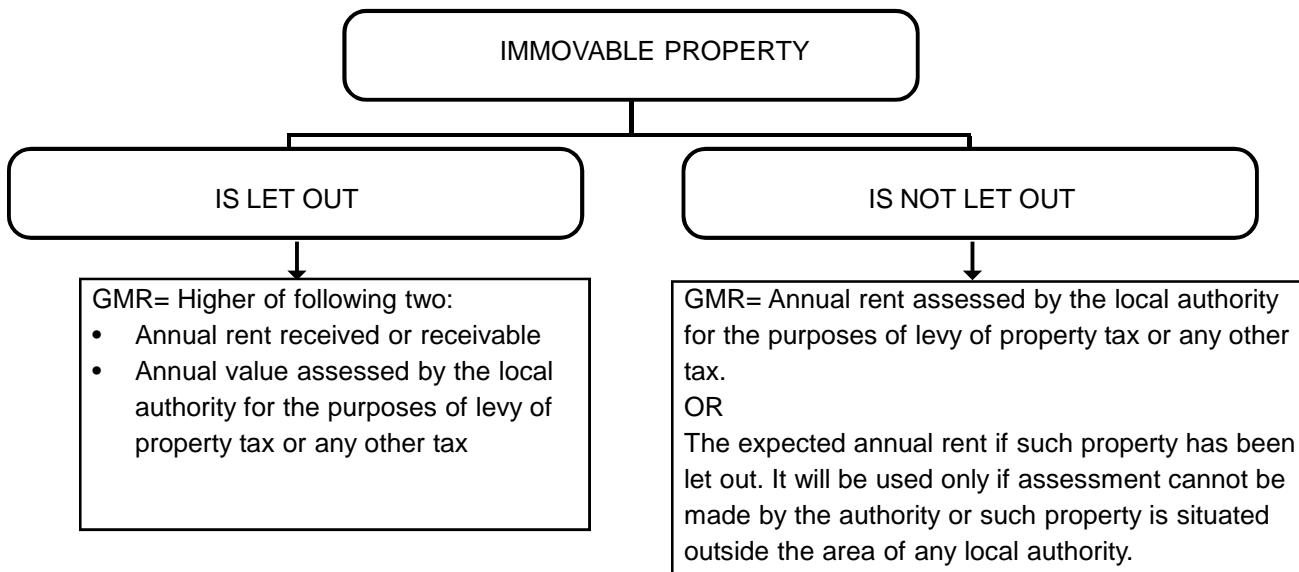
Add:

- Local taxes paid by the tenant
- 1/9th of the actual rent (if repairs expenditure is borne by the tenant)
- 15% p.a. on deposit held by the owner for the number of the months (excluding part of a month) in the

previous year (but it does not include advance rent for a period not exceeding three months and the interest to be paid by the owner will be deducted from this amount)

- (Amount received for lease/ the number of years of the period of the lease) If the owner has received any amount by way of premium for leasing of the property.
- Any benefit or perquisite derived by the owner in consideration for leasing of the property or any modification of the terms of the lease.

(b) Computation of Gross maintainable rent (GMR) (Rule 5):



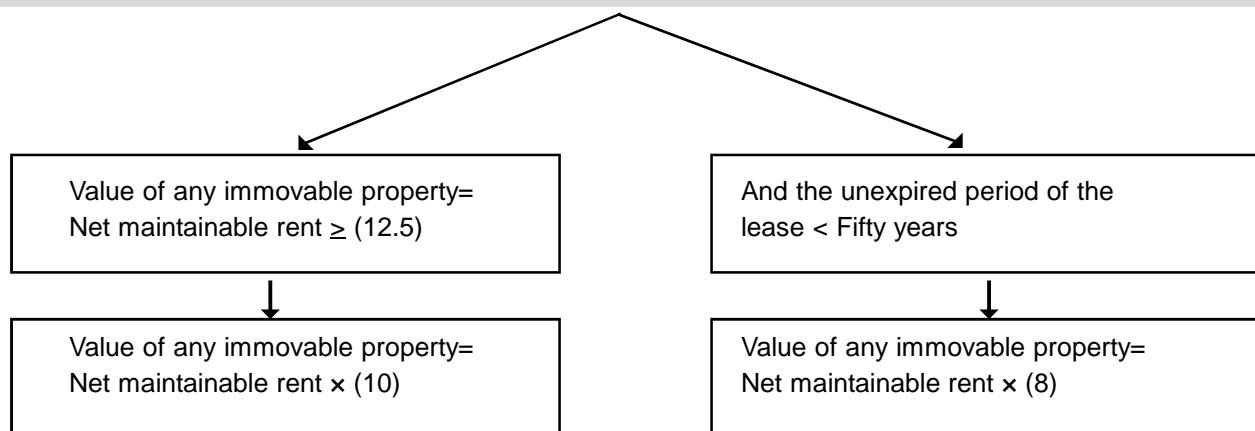
(c) Calculation of Net Maintainable Rent (Rule 4):

Gross maintainable rent

Less: Taxes levied by any local authority in respect of the property 15% of gross maintainable rent

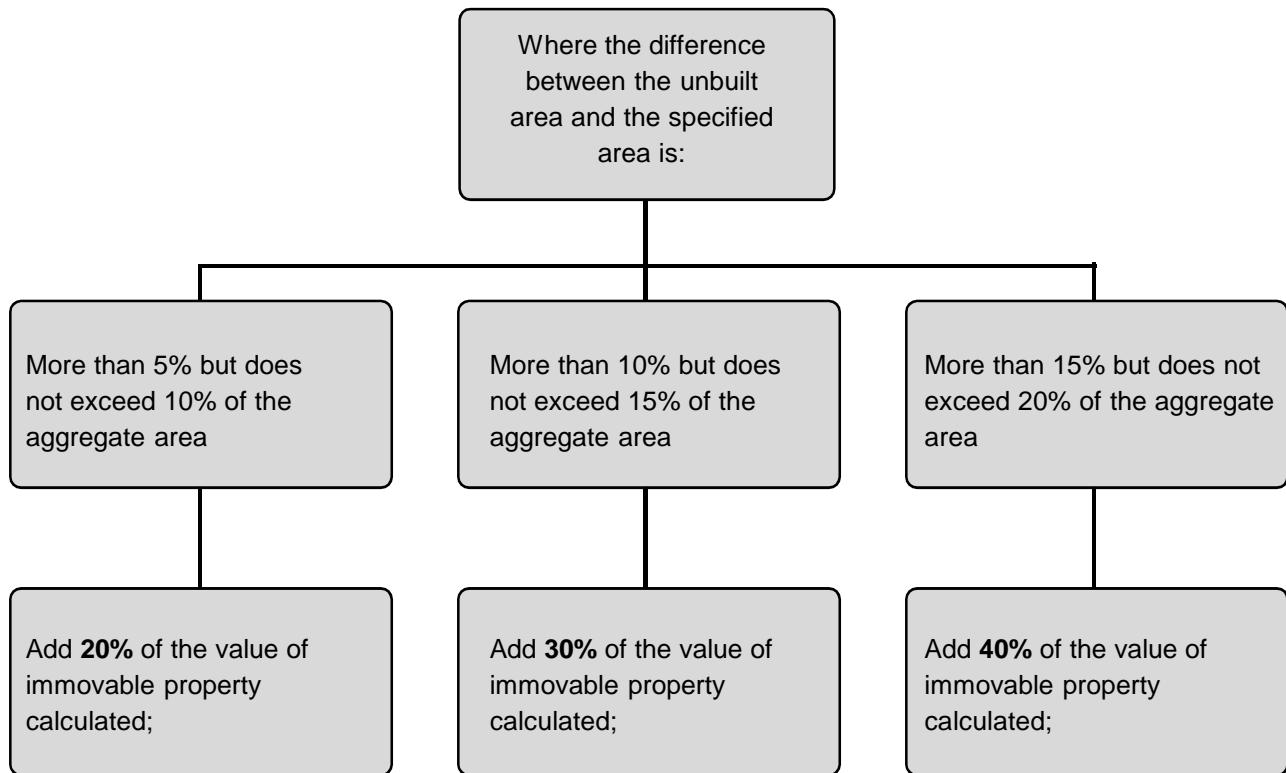
Net maintainable rent

(d) Value of any immovable property (Rule 3):



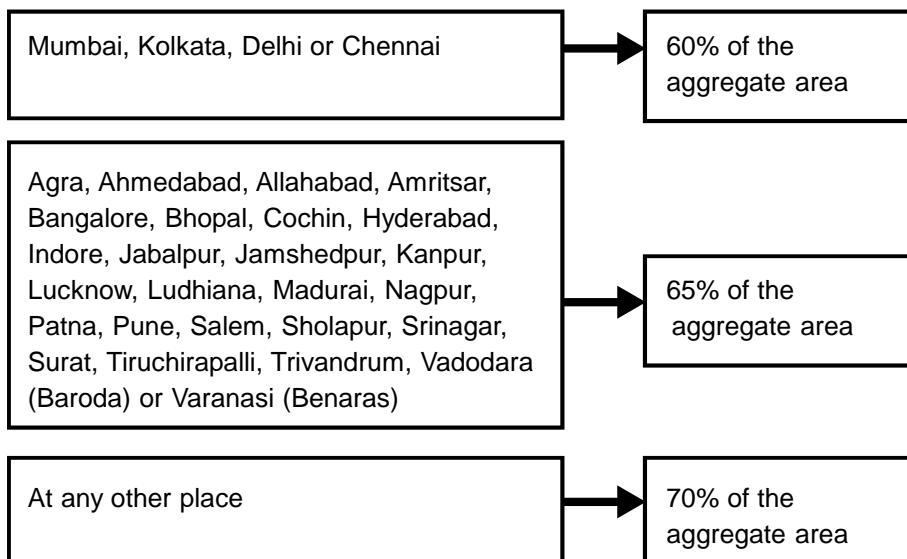
(e) Adjustments for unbuilt area of plot of land (Rule 6):

If the unbuilt area of the plot of land on which the property is constructed > the specified area, add following amount to the value of immovable property:



Meaning of terms used:

- Aggregate area means the aggregate of the area on which the property is constructed and the unbuilt area.
- Unbuilt area means that part of such aggregate area on which no building has been erected.
- Specified area means where the property is situated at:



- Specified area shall be the minimum area when such minimum area is kept as open space for the enjoyment of the property under any law for the time being in force and such minimum area is greater than the specified area.

(f) Adjustment for unearned increase in the value of the land (Rule 7):

It is applicable when:

- (a) The property is constructed on land obtained on lease from
 - the Government,
 - a local authority or
 - any authority referred to in clause (20A) of section 10 of the Income-tax Act,
 and
- (b) The Government or any such authority is entitled to claim and recover a specified part of the unearned increase in the value of the land at the time of the transfer of the property, under the terms of the lease.

The value of such property

Value of property as determined under Rule 3 after making

adjustment for unbuilt area of plot if any

XXX

Less: Lower of the following two

- Amount equal to 50% of the value of the property as determined above
- Amount liable to be claimed and recovered by the Government for unearned increase. XXX

where, unearned increase= (value of such land on the valuation date as determined by the Government or authority - amount of the premium paid or payable to the Government or such authority for the lease of the land)

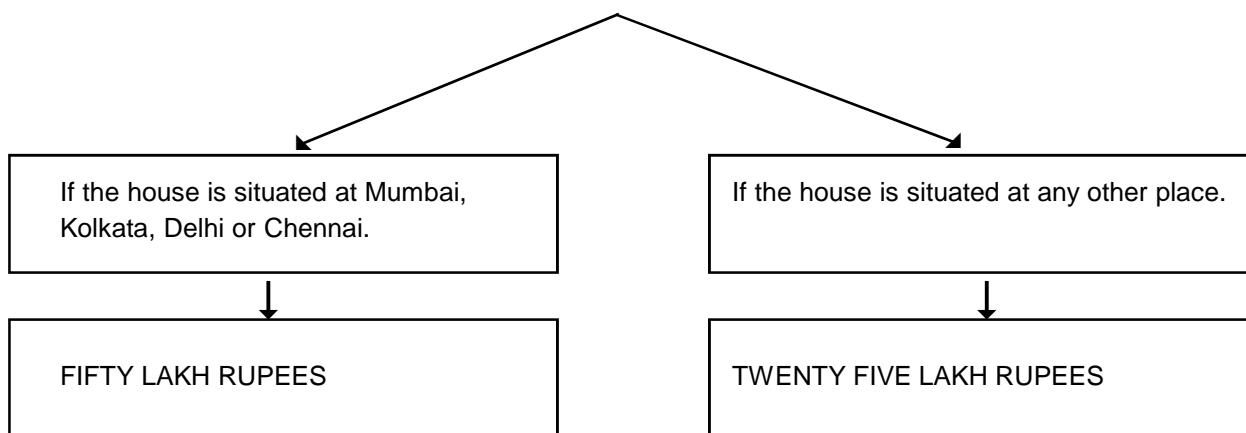
(g) Now compare the value derived with actual cost of acquisition,

If the property is acquired or construction of property is completed after the 31/03/1974. The value of such property will be higher of following:

- Value derived above after all the adjustments.
- Actual cost of acquisition/construction and cost of improvement.

This clause will not be applicable for:

- Only one residential house exclusively used for his own residential purposes throughout the period of 12 months immediately preceding the valuation date and
- If the actual cost of acquisition/construction plus cost of improvement, does not exceed, –

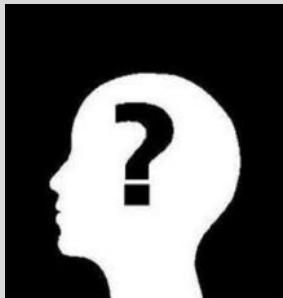


(h) Non applicability of Rule 3 (Rule 8):

The valuation of immovable property in following cases shall be determined in the manner laid down in Rule 20.

- Where, having regard to the facts and circumstances of the case, the Assessing Officer, with the previous approval of the Deputy Commissioner, is of opinion that it is not practicable to apply the provisions of the said rule to such a case; or
- Where, (unbuilt area - specified area) > 20% of the aggregate area; or
- Where, the immovable property is constructed on leasehold land and the lease is for a period = 15 years from the relevant valuation date and there is no provision for the renewal of the lease.

Test your knowledge



3. Which of the following falls under the specified area?

- (a) The property situated at Agra, Ahmedabad, Allahabad, Amritsar, 60% of the aggregate area
- (b) The property situated at Mumbai, Kolkata, Delhi or Chennai, 60% of the aggregate area
- (c) The property situated at Salem, Sholapur, Srinagar, Surat, 70% of the aggregate area
- (d) The property situated at Jamshedpur, Kanpur, Lucknow, Ludhiana, 70% of the aggregate area.

(B) VALUATION OF ASSETS OF BUSINESS

The valuation of immovable property is described in Part D of Schedule III of the Wealth tax Act. As per Rule 14(1), for the assessee who is carrying on a business and has maintained accounts regularly, the value of Net Assets (Total Assets minus Total liabilities) will be calculated on the basis of Balance Sheet of the assessee to determine the value of business, subject to the conditions mentioned under Rule 14(2).

Following are the conditions mentioned in Rule 14(2):

- (i) The value of the asset will be the value as disclosed in the balance-sheet. The depreciable assets will be valued at written-down value, Non depreciable assets at book value and the Closing stock value will be as adopted under the Income-tax Act.
- (ii) If the value of asset as determined under Rule 14(2)(a) exceeds the value calculated under Schedule III of this Act by more than 20%, then the higher value shall be taken to be the value of that asset.
- (iii) If the value of an asset is not disclosed in the balance-sheet, determine the value under Schedule III of this Act.

Assets not to be Included: [Rule 14(2)(d)]

Following assets even if disclosed in the balance sheet shall not be included in calculating the Value of Assets of Business:

- (i) Advance tax paid under the Income-tax Act;
- (ii) the debt due to the assessee according to the balance-sheet or part thereof which has been allowed as a deduction under clause (vii) of sub-section (1) of section 36 of the Income-tax Act, for the purposes of assessment for the previous year relevant to the corresponding assessment year under that Act;

- (iii) The value of any asset in respect of which wealth-tax is not payable under this Act;
- (iv) Any amount shown in the balance-sheet including the debit balance in the profit and loss account or profit and loss appropriation account which does not represent the value of any asset;
- (v) Any asset shown in the balance-sheet not really pertaining to the business;

Liabilities not to be Considered: [Rule 14(2)(e)]

Following amounts shown as liabilities in the balance-sheet shall not be considered:

- (i) Capital employed in the business other than that attributable to borrowed money;
- (ii) Reserves by whatever name called except provision for taxation;
- (iii) Any provision made for meeting any future or contingent liability;
- (iv) Any liability shown in the balance-sheet not really pertaining to the business;
- (v) Any debt owed by the assessee to the extent to which it has been specifically utilised for acquiring an asset in respect of which wealth-tax is not payable under this Act. Provided that where it is not possible to calculate the amount of debt so utilised, it shall be taken as the amount which bears the same proportion to the total of the debts owed by the assessee as the value of that asset bears to the total value of the assets of the business.

(C) VALUATION OF INTEREST IN FIRM OR ASSOCIATION OF PERSONS

The Part E of the Schedule III of the Wealth Tax Act deals with the Valuation of Interest in firm or association of persons. As per Rule 15 the value of the interest of a person in a firm of which he is a partner or in an association of persons of which he is a member shall be determined in the manner provided in Rule 16.

STEP 1: The net wealth of the firm or association of persons on the valuation date shall first be determined as if it were the assessee.

STEP 2: The portion of the net wealth of the firm or association, as is equal to the amount of its capital shall be allocated among the partners or members in the proportion in which capital has been contributed by them.

STEP 3: The residue shall be allocated amongst the partners or members in accordance with the agreement of partnership or association for distribution of assets in the event of dissolution of the firm or association.

STEP 4: In absence of such agreement, the apportionment of net wealth shall be done in the proportion in which the partners or members are entitled to share the profits.

STEP 5: The sum total of the amounts so allocated to the partner/member under steps 2 to 4 shall be taken as the value of interest of that partner or member in the firm or association.

Test your knowledge



4. Which is the next step that you follow after the net wealth of the firm or association of persons on the valuation date is determined?

- (a) Net wealth equal to the amount of its capital is allocated among the partners.
- (b) Residue is allocated amongst the partners or members in accordance with the agreement of partnership.
- (c) Apportionment of net wealth is done in the proportion in which the partners or members are entitled to share the profits.
- (d) The sum total of the amounts allocated to the partner is taken as the value of interest of that partner.

(D) VALUATION OF LIFE INTEREST

According to the Rule 17(1) (Part F of Schedule III), the value of the life interest of an assessee is—

[(Average annual income accrued to the assessee from the life interest) * $\{1/(p+d)-1\}$].

Where,

p = the annual premium for a whole life insurance without profits on the life of the life tenant for unit sum assured as specified in the Appendix to these rules

$d = i / (1+i)$, i is the rate of interest.

$i = 6\frac{1}{2}$ % per annum

Average annual income= (Average gross annual income) – (Average Expenses incurred on collection of such income)

Average annual gross income = (Total gross income from the life interest) / (Total number of years)

Average Expenses = (Total expenses incurred on the collection of such income) / (Total number of years)

Note:

- Average expenses incurred on collection of such income shall not exceed 5% of the average annual gross income.
- Average annual income will be calculated only for the period of maximum 3 years preceding the period ending on the valuation date
- The Assessing Officer may vary the normal premium rates in force and determine value accordingly if he thinks that the normal rates are low or any insurance company would not provide insurance at that premium.
- The value of the life interest determined above shall not be greater than the value of the corpus of the trust determined under schedule III of this Act.

(E) VALUATION OF JEWELLERY (PART G OF SCHEDULE III)

The value of the jewellery shall be estimated to be the price which it would fetch if sold in the open market on the valuation date i.e. the fair market value. The return of net wealth furnished by the assessee shall be supported by,—

- a statement in the prescribed form (if the value of jewellery = 500,000)
- a report of a registered valuer in the prescribed form (if the value of jewellery > 500,000)

The Assessing Officer (AO) may refer the valuation of jewellery to a Valuation Officer under Section 16A(1) and the value of such jewellery shall be the value as estimated by the Valuation Officer, if AO is of the opinion that:

The value of the jewellery declared in the return < fair market value by such percentage as is prescribed under Section 16A(1)(b)(i) of the Act;

The value of the jewellery declared in the return < fair market value.

The value of jewellery so estimated by the Valuation Officer shall be taken to be the value of such jewellery for the subsequent 4 (four) assessment years, subject to the following adjustments:—

- where the jewellery includes gold or silver or any alloy containing gold or silver, the value of such gold or silver or such alloy as on the valuation date relevant to the concerned subsequent assessment year shall be substituted for the value of such gold or silver or alloy on the valuation date relevant to the first assessment year;
- where any jewellery or part of jewellery is sold or otherwise disposed of by the assessee, or any jewellery or part of jewellery is acquired by him, on or before the valuation date relevant to the concerned

subsequent year, the value of the jewellery determined for the first assessment year shall be reduced or increased, as the case may be, and the value as so reduced or increased shall be the value of the jewellery for such subsequent assessment year.

(F) VALUATION OF ASSETS IN OTHER CASES (PART H OF SCHEDULE III)

The value of any asset, other than cash, not covered by above schedules shall be the fair market value as in the opinion of the Assessing Officer on the valuation date.

If the valuation of any asset is referred by the Assessing Officer to the Valuation Officer under section 16A, the value of such asset, shall be the fair market value as in the opinion of the valuation officer on the valuation date.

If the value of any asset cannot be estimated under this rule because it is not saleable in the open market, the value shall be determined in accordance with such guidelines or principles as may be specified by the Board from time to time by general or special order.

The price or other consideration for which any property may be acquired by or transferred to any person under the terms of a deed of trust or through or under any restrictive covenant in any instrument of transfer shall be ignored for the purposes of determining value under any provision of this Schedule and the price of such property would be the price the property would fetch if sold in the open market on the valuation date.

ROUNDING OFF OF NET-WEALTH (SECTION 44C)

Under Section 44C, the net-wealth computed under the provisions of the Act shall be rounded off to the nearest multiple of ₹ 100. If the amount contains a part of one hundred rupees and if such part is fifty rupees or more, the amount shall be increased to the next higher amount which is multiple of hundred. If such part is less than fifty rupees, the amount shall be reduced to the next lower amount which is a multiple of one hundred. The amount so rounded off shall be deemed to be the net-wealth of the assessee.

ROUNDING OFF OF TAX, INTEREST, PENALTY ETC. (SECTION 44D)

The amount of wealth-tax, interest, penalty, fine or any other sum payable or refundable under the Act shall be rounded off to the nearest rupee. If the amount contains a part of rupee, then, if such part is fifty paise or more, it shall be increased to one rupee and if such part is less than fifty paise it shall be ignored.

Illustration

Ram owns a house which is constructed on leasehold land acquired from DHA (Delhi Housing Authority).

This house has been let out to Shyam for ₹ 15000 per month under following terms and conditions:

- He will pay 40% of the municipal taxes and bear cost of repairs.
- He is also required to give advance of ₹ 200,000 which will be interest free.
- He will pay the premium for leasing the property for five years of amount ₹ 100,000.

Other Informations:

- The annual value assessed by the local authority is ₹ 1,50,000
- Local taxes levied are ₹ 15,000.
- Expenditure on repairs by Shyam ₹ 20,000
- Difference between aggregate area and unbuilt area is 16% of the aggregate area.
- Cost of building including land in 1985 was ₹ 10,00,000
- DHA's current value of land is ₹ 500,000 and it charges 50% of the unearned increase on the transfer of a house.

- Ram acquired land for ₹ 90000 from DHA.
- Unexpired period of lease is 90 yrs.

Compute the value of house property for the purpose of wealth tax of Ram.

Solution

Computation of value of house property for Ram

Step 1: Determination of annual rent received

Actual rent received	$(15,000 \times 12)$	180,000
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Add:

Municipal tax paid by tenant (40% of 15,000)	6000
Repairs (1/9th of 180,000)	20,000
Interest on deposit (15% of 2,00,000)	30,000
Premium on lease (100,000/5)	<u>20,000</u>

Annual rent received	<u>2,56,000</u>
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Step 2: Calculation of GMR

Annual rent received	2,56,000
Annual value assessed by the authority	<u>1,50,000</u>
GMR (higher of above two)	<u>2,56,000</u>

Step 3: Calculation of NMR:

GMR	2,56,000
<i>Less:</i>	
Taxes levied by local authority	15,000
15% of GMR (15% of 2,56,000)	<u>38,400</u>
NMR	<u>2,02,600</u>

Step 4: Capitalised value of immovable property

$$\begin{aligned}
 \text{Capitalised value} &= \text{NMR} * 10 \\
 &= 2,02,600 * 10 \\
 &= 20,26,000
 \end{aligned}$$

Step 5: Adjustment for unbuilt area of land

Capitalised value	20,26,000
<i>Add:</i>	
30% of Capitalised value as premium	<u>6,07,800</u>
Value of immovable property after adjustment for unbuilt area of land	<u>26,33,800</u>

Step 6: Adjustment for unearned increase

Value of immovable property after adjustment for unbuilt area of land	26,33,800
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Less :

50% of Value of immovable property (26,33,800) or	13,16,900
Amount liable to be recovered by authority for unearned increase (50% of 500,000 – 90,000)	
Lower of above two	<u>1,60,000</u>
	<u>1,60,000</u>
Value of immovable property after adjustment for unearned increase	24,73,800

Step 7: The property is acquired after 31/03/1974, therefore the value of property will be higher of value determined above (₹ 24,73,800) and actual cost of acquisition (₹ 10,00,000).

Therefore value of house property for wealth tax of Ram is ₹ 24,73,800.

Illustration

A owns a house property which is situated at Delhi and is used for residential purposes throughout the year. The annual value of the property as per the municipal records is ₹ 1,00,000, whereas the rent received from the tenant is ₹ 80,000. The municipal taxes are paid partly by A (₹ 3,000) and partly by the tenant (₹ 5,000). The tenant bears the entire repair expenses of ₹ 5,000. He also deposited with the landlord a sum of ₹ 25,000 as refundable security which, however, does not carry any interest. The difference between 'unbuilt area' and 'specified area' does not exceed 5 per cent. What will be the value of the house property on March 31, 2014 if (i) the house is built on freehold land; (ii) it was acquired later than April 1, 1975, for ₹ 10,00,000; and (iii) the cost of improvement is ₹ 20,000. Assessment year 2014-2015.

Solution

**Computation of Value of House Property
as on 31st March 2014**

	₹	₹
GROSS MAINTAINABLE RENT		
(a) Annual value, i.e. the municipal valuation of the property		1,00,000
(b) Annual Rent		
– Actual rent paid by the tenant	80,000	
– Add: one ninth of ₹ 80,000 as repair expenses borne by the tenant	8,888	
– Municipal taxes borne by the tenant	5,000	
– Interest @ 15% on deposit of ₹ 25,000	3,750	97,638
Gross Maintainable rent, being the higher of Municipal Valuation and Annual Rent		1,00,000
Less: Municipal Taxes (₹ 3,000 + ₹ 5,000)		(–) 8,000
15% of ₹ 1,00,000		(–) 15,000
NET MAINTAINABLE RENT		77,000
CAPITALISED VALUE		
Property constructed on freehold land (77,000 x 12.5)		
Value of property :		9,62,500

Since the property is acquired after 1.4.1975, its value will be ₹ 10,00,000 + ₹ 20,000 i.e. 10,20,000. But, since it is used for residential purposes throughout the period of 12 months preceding the valuation date, the rule of substitution of actual cost of construction/improvement will not apply. Therefore, the value of property shall be ₹ 9,62,500.

Illustration

Jolly has the following assets and liabilities on the valuation date i.e., 31st March, 2014:

	₹ in lakhs
(i) Residential house	60.0
(ii) A farm house – 15 kms. away from the local limit of Calcutta	30.0
(iii) Car for personal use	16.0
(iv) Jewellery	24.0
(v) Air craft for personal use	180.0
(vi) Urban land (construction is not permitted under the law)	40.0
(vii) Cash in hand	11.0
(viii) Loan taken to purchase the air-craft	80.0

Compute the net-wealth of Jolly for the assessment year 2014-15.

Solution:

Computation of net-wealth of Jolly for the assessment year 2014-15

Particulars	₹ in lakhs
(i) Residential house exempt under Section 5(vi)	—
(ii) Farm House	30.00
(iii) Car for personal use	16.00
(iv) Jewellery	24.00
(v) Aircraft for personal use	180.00
(vi) Urban land [construction is not permitted under the law, hence not an asset under Section 2(ea) of the Wealth-tax Act, 1957]	—
(vii) Cash in hand (in excess of ₹ 50,000 is an asset)	10.50
Gross Wealth	260.50
<i>Less: Loan taken to purchase the aircraft</i>	<i>(80.00)</i>
Net Wealth	180.50

RETURN OF WEALTH

(1) Voluntary Return

The procedure under the Wealth-tax Act for making the assessment of net wealth begins with the filing of a return of wealth. Section 14 of the Act contains the relevant provisions relating to the filing of return of Wealth. According to that section it is statutorily obligatory for every person, if his net wealth or the net wealth of any

other person in respect of which he is assessable under this Act on the valuation date exceeded the maximum amount which is not chargeable to wealth-tax, shall, on or before the due date, furnish a return of his net wealth or the net wealth of such other person as on that valuation date in the prescribed form and verified in the prescribed manner setting forth particulars of such net wealth and such other particulars as may be prescribed.

Explanation: Sub-section(1) specifies the “due date” in relation to an assessee under the Wealth-tax Act, to be the same date as that applicable to an assessee under the Income-tax Act under the Explanation to Sub-section (1) of Section 139 of the Income-tax Act, i.e.,

- (a) Where the assessee is a company, the 30th day of September of the assessment year;
- (b) Where the assessee is a person, other than a company:
 - (i) in a case where the accounts of the assessee are required under the Income Tax Act or any other law to be audited or in the case of a partner of a firm where the accounts of the firm are required to be so audited, or, in the case of a co-operative society, the 30th day of September of the assessment year;
 - (ii) in a case where the total income referred to in Sub-section (1) of Section 139 includes any income from business or profession, not being a case falling under Sub-clause (i) hereinabove, the 31st day of July of the assessment year;
 - (iii) in any other case, the 31st day of July of the assessment year.

However, notwithstanding anything contained in any other provisions of the Wealth-tax Act, a return of net wealth which shows the net wealth below the maximum amount which is not chargeable to tax shall be deemed to have never been furnished.

It is further provided that Sub-section (2) shall not apply to a return furnished in response to a notice under Section 17;

(2) Return after Due Date and Amendment of Return (Section 15)

If any person has not furnished a return within the time allowed under Section 14(1) or under a notice issued under Section 16(4)(i), or having furnished a return discovers any omission or a wrong statement therein, he may furnish a belated return or revised return at any time before the expiry of one year from the end of the relevant assessment year or before the completion of assessment, whichever is earlier.

An assessment is made or completed when the order of assessment is signed by the Assessing Officer, and not when the assessment order or notice of demand is served on the assessee. If the assessee files the belated return or revised return before the assessment is made, the Assessing Officer is bound to consider such return and he cannot assess the assessee under Section 17 (wealth escaping assessment).

Return by whom to be signed (Section 15A)

The return of wealth must be signed and verified:

- (a) In case of an individual:
 - (i) by individual himself;
 - (ii) where the individual is absent from India, by the individual concerned or by a person duly authorised by him;
 - (iii) where the individual is mentally incapacitated from attending to his affairs, by his guardian or any other person competent to act on his behalf;
 - (iv) where for any other reason it is impossible for the individual to sign the return, by any person competent to act on his behalf.

- (b) In case of Hindu undivided family:
 - (i) by the Karta;
 - (ii) where the karta is absent from India or is mentally incapacitated from attending to his affairs, by any other adult member of the family; and
- (c) In the case of a company:
 - (i) by the Managing Director of the company;
 - (ii) where the Managing Director, because of any unavoidable reason could not sign the return, or where there is no Managing Director, by any Director thereof.
 - (iii) where the company is being wound up, whether under the orders of the Court or otherwise, or where any person has been appointed as the receiver of any assets of the company, the return has to be signed and verified by the liquidator referred to in Section 178(1).
 - (iv) where the management of the company has been taken over by the Central Government or any State Government under any law, the return has to be signed and verified by the principal officer thereof.
 - (v) where the company is not resident in India the return may be signed and verified by any person who holds a valid power of attorney from such company to do so, which shall be attached to the return.

POWER OF BOARD TO DISPENSE WITH REFURNISHING DOCUMENTS ETC. WITH RETURN OF WEALTH (SECTION 14A)

For a particular class or classes of persons the Board has a power to exempt such person or classes of person from the requirement of furnishing documents, statements, receipts, certificates, audit report, reports of register valuer or any other document which are required to be furnished along with return of net wealth. But, such documents are required whenever the demand is made by the Assessing Officer.

FILING OF RETURN IN ELECTRONIC FORM (SECTION 14B)

The Board has power to make rules for a particular class or classes of persons who shall be required to furnish the return in electronic form in such a form and manner as may be prescribed by Board.

The Board also has a power to make rules providing for documents, statements, receipts, certificates, audit report, reports of register valuer or any other document which may not to be furnished along with return of net wealth. But, such documents are required whenever the demand is made by the Assessing Officer. It may be prescribed ten ways of making electronic records.

ASSESSMENT

(1) Self Assessment [Section 15B]

Where any tax is payable on basis of any return furnished under Section 14 or Section 15 or in response to a notice under clause (i) of Sub-section 4 of Section 16 or under Section 17, after taking into account the amount of tax, if any, already paid under any provision of this Act, the assessee shall be liable to pay such tax, together with interest payable under any provision of this Act for any delay in furnishing the return, before furnishing the return and the return shall be accompanied by proof of payment of such tax and interest.

Where the amount paid by the the assessee under Sub-section (1) (as above), falls short of the aggregate of the tax and interest as aforesaid, the amount so paid shall first be adjusted towards the interest payable as aforesaid and the balance, if any, shall be adjusted towards the tax payable.

After the regular assessment under Section 16 has been made, any amount paid under Sub-section (1) shall be deemed to have been paid towards such regular assessment.

If any assessee fails to pay the whole or any part of such tax or interest or both in accordance with the provisions of Sub-section (1), he shall, without prejudice to any other consequences which he may incur, be deemed to be an assessee in default in respect of the tax or interest or both remaining unpaid and all the provisions of this Act shall apply accordingly.

(2) Assessment

Section 16, provides for assessment, as follows:

- (1) Where a return has been made voluntarily or after due date or in response to a notice under clause (i) of Sub-section (4), -
 - (i) if any tax or interest is found due on the basis of such return after adjustment of any amount paid by way of tax or interest, an intimation shall be sent to the assessee specifying the sum so payable, and such intimation shall be deemed to be a notice issued under Section 30 and all the provisions of the Act shall apply accordingly; and
 - (ii) if any refund is due on the basis of such return, it shall be granted to the assessee and an intimation to this effect shall be sent to the assessee.

Provided that except as otherwise provided in this sub-section the acknowledgement of the return shall be deemed to be intimation under this sub-section where either no sum is payable by the assessee or no refund is due to him.

An intimation for any tax or interest due under this clause shall not, however, be sent after the expiry of two years from the end of assessment year in which the net wealth was first assessable.

- (2) In the above cases, if the Assessing Officer considers it necessary or expedient to ensure that the assessee has not understated the net wealth or has not underpaid the tax in any manner, he shall serve on the assessee a notice requiring him, on a date to be specified therein, either to attend at the office of the Assessing Officer or to produce, or cause to be produced there, any evidence on which the assessee may rely in support of the return:

Provided that no notice under the sub-section shall be served on the assessee after the expiry of twelve months from the end of the month in which the return is furnished.

- (3) On the day specified in the notice issued under Sub-section (2) or as soon afterwards as may be, after hearing such evidence as the assessee may produce and such other evidence as the Assessing Officer may require on specified points, and after taking into account all relevant material which he has gathered, the Assessing Officer shall, by order in writing, assess the net wealth of the assessee and determine the sum payable by him on the basis of such assessment.

- (4) For the purposes of making an assessment under the Act, the Assessing Officer may serve, on any person who has made a return under Section 14 or Section 15 or in whose case the time allowed under Sub-section (1) of Section 14 for furnishing the return has expired, a notice requiring him on a date to be specified therein, -

- (i) where such person has not made a return within the due date, to furnish a return of his net wealth or the net wealth of any other person in respect of which he is assessable under this Act, on the valuation date, in the prescribed form and verified in the prescribed manner, setting forth the particulars of such net wealth and such other particulars as may be prescribed, or
 - (ii) to produce or cause to be produced such accounts, records or other documents as the Assessing Officer may require.

(5) If any person, –

- (a) fails to make the return required under Sub-section (1) of Section 14 and has not made a return or a revised return under Section 15, or
- (b) fails to comply with all the terms of a notice issued under Sub-section (2) or Sub-section (4).

the Assessing Officer shall, after taking into account all relevant material which he has gathered, and after giving such person an opportunity of being heard, estimate the net wealth to the best of his judgement and determine the sum payable by the person on the basis of such assessment:

Provided that such opportunity shall be given by the Assessing Officer by serving a notice calling upon the person to show cause, on a date and time to specified in the notice, why the assessment should not be completed to the best of his judgement:

Provided further that it shall not be necessary to give such opportunity in a case where a notice under Sub-section (4) has been issued prior to the making of the assessment under the sub-section.

Where a regular or best judgement assessment is made, any tax or interest paid by the assessee shall be deemed to have been paid towards such regular assessment and, if no refund is due on regular assessment and the amount refunded exceeds the amount refundable on regular assessment, the whole of the excess refunded shall be deemed to be tax payable by the assessee.

(3) Reference to Valuation Officer (Section 16A)

Where for making a Wealth-tax assessment under the Act and Section 7 thereof, read with the relevant rules (in Wealth-tax Rules as well as Schedule III), the market value of any asset is to be taken into account in such assessment, the Assessing Officer may refer the valuation of any asset to the Valuation Officer under the following circumstances.

- (i) where the value of the asset has been estimated by a registered valuer and the Assessing Officer is of the opinion that the value estimated by the registered valuer is less than its fair market value and it requires an upward revision;
- (ii) in any other case, if the Assessing Officer is of the opinion that fair market value of the asset exceeds the value of the asset as returned by more than 33-1/3% or by more than ₹ 50,000; or
- (iii) if he considers it necessary to do so on account of the nature of the asset and other relevant circumstances.

On a reference having been made to the valuation officer, he will proceed to value each asset separately after giving notice to the assessee to produce or cause to be produced before him, such accounts, records or other documents as he may require.

Where the Valuation Officer is of the opinion that the value of the asset has been correctly declared in the return made by the assessee, he shall pass an order in writing and send a copy of it to the Assessing Officer and to the assessee. Where the Valuation Officer is of the opinion that the value of the asset is higher than the value declared by the assessee, or where the asset is not disclosed, or the value of the asset is not declared in the return, or, where no such return has been made, he shall serve a notice on the assessee intimating the value which he proposes to estimate and give him an opportunity to state the objections, if any, on the date specified by the Valuation Officer. The assessee, either in person or through any other person, or in writing, can file his objections or produce or cause to be produced such evidence as he wants to rely on in support of his objections.

After hearing all the evidence which the assessee may produce and considering all the material which the Valuation Officer has gathered, he shall estimate the value of the asset and send a copy of his order to the Assessing Officer and the assessee. The order of the Valuation Officer is binding on the Assessing Officer who, after receiving the order, shall proceed to complete the assessment in conformity with the estimate of the Valuation Officer. Where the Valuation Officer values an asset for an amount less than the amount returned by the assessee,

the value assessed by Assessing Officer would be final. Further, the assessee can file an appeal against valuation report and valuation officer is bound to follow valuation rules given under Schedule III.

(4) Wealth Escaping Assessment (Section 17)

If the Assessing Officer has reason to believe that the net wealth chargeable to tax in respect of which any person is assessable under the Wealth-tax Act, has escaped assessment for any assessment year (whether by reason of under assessment or assessment at too low a rate or otherwise), he may, subject to the other provisions of this Section and Section 17A, serve on such person a notice requiring him to furnish within such period, as may be specified in the notice, a return in the prescribed form and verified in the prescribed manner setting forth the net wealth in respect of which such person is assessable as on the valuation date mentioned in the notice, along with such other particulars as may be required by the notice, and may proceed to assess or reassess such net wealth and also any other net wealth chargeable to tax in respect of which such person is assessable, which has escaped assessment and which comes to his notice subsequently in the course of the proceedings under this section for the assessment year concerned and the provisions of the Wealth-tax Act shall, so far as may be, be applicable as if the return were a return required to be furnished under Section 14.

It is further provided that in cases where assessment under Section 16(3) or this section has been made for the relevant assessment year, no action shall be taken under this section after expiry of four years from the end of the relevant assessment year unless any net wealth chargeable to tax has escaped assessment for such assessment year by reason of failure on the assessee's part to: (i) make a return under Section 14 or 15 or in response to a notice issued under

Section 16(4) or this section or, (ii) full and true disclosure of all material facts necessary for his assessment for that assessment year. And, the Assessing Officer shall, before issuing any notice under this sub-section, record his reasons for doing so.

Explanation to the proviso (as above) clarifies that production of account books and other evidence, before the Assessing Officer, from which material evidence could have been discovered by the Assessing Officer with due diligence will not necessarily amount to disclosure.

It is provided further that the period of 4 years or six years shall be extended to sixteen years where any net wealth in relation to any asset (including financial interest in any entity) located outside India chargeable to tax, has escaped assessment for any assessment year

Sub-section (1A) provides that notice specified at paragraph (1) hereinabove shall not be issued for the relevant assessment year –

- (a) if four years have elapsed from the end of the relevant assessment year, unless the case falls under clause (b);
- (b) if four years, but not more than six years, have elapsed from the end of the relevant assessment year unless the net wealth chargeable to tax which has escaped assessment amounts to or is likely to amount to rupees ten lakh or more for that year.

(1B)(a) This sub-section restrains issuance of notice by an Assessing Officer below the rank of Assistant Commissioner or Deputy Commissioner unless the Joint Commissioner is satisfied on the reasons recorded by such Assessing Officer that it is a fit case for the issue of such notice in cases where assessment under Section 16(3) or 17(1) has been made for the relevant assessment year.

Additional restraint made by proviso to this sub-section is: after the expiry of four years from the end of the relevant assessment year, notice to be issued only if the Commissioner or Chief Commissioner is satisfied on the reasons recorded by such Assessing Officer about the case being a fit one for the issuance of notice.

(b) In case other than the ones specified at (a) above, no notice shall be issued under Sub-section (1) by an Assessing Officer below the rank of Joint Commissioner, after the expiry of four years from the end of the relevant assessment year, unless the Joint Commissioner is satisfied, on the reasons recorded by such Assessing Officer, that it is a fit case for the issue of such notice.

Sub-Section (2) to Section 17 states that the aforementioned time limit within which any proceeding for assessment or reassessment may be commenced shall not apply to an assessment or reassessment to be made on such person in consequence of or to give effect to any finding or direction contained in an order passed pursuant to: (i) Section 23 [Appeal to the Commissioner (Appeals)]; (ii) Section 24 (Appeal to Appellate Tribunal); (iii) Section 25 (Revisions of orders by Commissioner); (iv) Section 27 (Reference to High Court); (v) Section 29 (Appeal to Supreme Court) or by a Court in any proceeding under any other law.

However, the provisions of Sub-section (2) shall not apply in any case where the assessment or reassessment relates to an assessment year in which an assessment or reassessment could not have been made at the time the order which was the subject matter of the appeal, revision or reference, was made by reason of any provision limiting the time within which any action for assessment or reassessment may be taken.

(4) Time limit for completion of Assessment and Re-assessment

Section 17A, provides as follows:

- (1) No order of assessment shall be made under Section 16 at any time after the expiry of two years from the end of the assessment year in which the net wealth was first assessable:

Provided that:

- (a) Where the net wealth was first assessable in the assessment year commencing on 1.4.1987 or any earlier assessment year, the assessment can be made on or before 31.3.1991.
- (b) Where the net wealth was first assessable in the assessment year commencing on 1.4.1988, such assessment can be made on or before 31.3.1992.

Provided further that in case the Assessment Year in which the net wealth was first assessable is the assessment year commencing on the 1st day of April, 2004 or any subsequent year, the provisions of this sub-section shall have effect as if for the words "two years", the words "twenty-one months" had been substituted.

- (2) No order of assessment or reassessment shall be made under Section 17 after the expiry of one year from the end of the financial year in which the notice under 17(1) was served:

However, where the notice under Sub-section (1) of Section 17 was served on or after the 1st day of April, 1999 but before the 1st day of April, 2000, such assessment or reassessment may be made at any time upto the 31st day of March, 2002.

Provided further that where the notice under sub-section (1) of Section 17 was served on or after the 1st day of April, 2005, the provisions of this sub-section shall have effect as if for the words "one year", the words "nine months" had been substituted".

Sub-section (3) of Section 17A provides that notwithstanding anything contained in Sub-section (1) and (2) of Section 17A, an order of fresh assessment in pursuance of an order passed on or after 1.4.1975 under Section 23A, Section 24 or Section 25 setting aside or cancelling an assessment, may be made at any time before the expiry of one year from the end of the financial year in which the order under

Section 23A or Section 24 is received by the Chief Commissioner or Commissioner as the case may be, the order under Section 25 is passed by the Commissioner.

However, where the order under Section 23A or Section 24 is received by the Chief Commissioner or Commissioner or, as the case may be, the order under Section 25 is passed by the Commissioner, on or after

the 1st day of April, 1999 but before the 1st day of April, 2000, such an order of fresh assessment may be made at any time upto the 31st day of March, 2002.

Provided further that where the order under Section 23A or Section 24 is received by the Chief Commissioner or Commissioner or, as the case may be, the order under Section 25 is passed by the Commissioner, on or after the 1st day of April, 2005, the provisions of this sub-section shall have effect as if for the words "one year", the words "nine months" had been substituted.

Where the assessment or re-assessment is made on an assessee or any other person in consequence of, or to give effect to, any finding or direction contained in an order passed on Appeal Revision or Reference; under Section 23, Section 24, Section 25, Section 27 or Section 29, or in an order of any court in a proceeding otherwise than by way of appeal or reference under the Wealth-tax Act, the time limits prescribed in Sub-sections (1) and (2) Sections 17A will not apply. Such assessment or re-assessment may be completed at any time subject to the proviso of Sub-section (3) of that section.

In computing the period of limitation the time taken in the following shall be excluded:

- (i) the time taken in re-opening the proceeding or in giving an opportunity to the assessee to be re-heard;
- (ii) the period during which the assessment proceeding is stayed by an order or injunction of any Court;
- (iii) the period, not exceeding sixty days, commencing from the date on which the Wealth-tax Officer received the declaration under Section 18C (1) and ending with the date on which the order under Sub-section (3) of Section 18C (regarding an identical question of law being pending before the High Court) is made by him or;
- (iv) where an application made before the Wealth-tax Settlement Commission is rejected by it, the period commencing from the date on which application is made and ending with the date on which the order is received by the Commissioner from the Commission.

However, where immediately after the exclusion of the aforesaid time or period, the period of limitation referred to in Sub-section (1), (2) and (3) available to the Assessing Officer for making an order of assessment or reassessment as the case may be, is less than sixty days, such remaining period shall be extended to sixty days and the aforesaid period of limitation shall be deemed to be extended accordingly.

LIABILITY TO ASSESSMENT IN SPECIAL CASES

(1) Tax of Deceased Person Payable by Legal Representative (Section 19)

Where a person dies, his executor, administrator or legal representative shall be liable to pay the Wealth-tax assessed or any other sum (interest, fine or penalty) payable by the deceased out of the estate of the deceased person to the extent to which the estate is capable of meeting the charge.

Where a person dies either without furnishing a return or after furnishing incorrect or incomplete return, the Assessing Officer may make an assessment and for this purpose he may serve the required notice to the legal representative to produce any accounts, documents or evidence which might have been required from the deceased person if he had survived.

The legal representative shall also be liable to file a return (if the deceased had not filed it) or a belated return or revised return or pay tax on wealth escaping assessment. However, his liability is restricted to the assessment years in which the assessee has expired or earlier assessment year for which the assessment has not been made. He shall not be liable for the tax for valuation date falling after his death.

If the penalties are imposed prior to death, the same may also be collected from the legal representative but, for the default made by the deceased, no penalty can be levied on the legal representative [Smt. Yawarunnissa Begum v. WTO (1975) 100 ITR 645 (A.P.)].

Similarly, the penalty proceedings commenced against the deceased cannot be continued after his death against his legal representative [Remeshwar Prasad v. CWT (1980) 124 ITR p. 77].

Following the Allahabad High Court's decision in the case of Rameshwari Prasad v. Commissioner of Wealth-tax (1980, 124 ITR 77) the Madhya Pradesh High Court held in the case of Commissioner of Wealth-tax v. Abdul Mazid Khan (1984, 147 ITR 53) that Section 19(1) does not provide for the continuation of penalty proceedings against the legal representative when the assessee dies before the proceedings are concluded. In the absence of any provision like Section 159 of the Income-tax Act, 1961 in the Wealth-tax Act, it could not be held that penalty proceedings started against an assessee under Section 18 could be continued against his legal representatives.

The Andhra Pradesh High Court's decision in the case of Smt. Yawarunnissa Begum v. Wealth-tax Officer (supra) was followed by the Allahabad High Court in the case of Ram Prasad (supra) and by the Madhya Pradesh High Court in the case of Abdul Mazid Khan (supra).

(2) Assessment in the case of Executors (Section 19A)

After the death of a person, his estate is chargeable to Wealth-tax in the hands of the executor/s who are treated as an individual and whose residence and citizenship shall be the same as those of deceased on the valuation date immediately preceding his death.

The assessment of an executor under this section shall be made separately from any assessment that may be made on him in respect of his own net wealth or on the net wealth of the deceased under Section 19.

Separate assessment shall be made on the executor in respect of the net wealth as on each valuation date from the date of the death of the deceased to the date of complete distribution to the beneficiaries of the estate according to their interests. If he has distributed any assets of the estate, the value thereof shall not be included in the net wealth of deceased but it shall be included in the net wealth of beneficiary, if he continues to own the asset on the valuation date.

(3) Assessment after Partition of a Hindu Undivided Family (Section 20)

Where, at the time of making an assessment, it is brought to the notice of the Assessing Officer that a partition has taken place, on the valuation date, amongst the members of a H.U.F. and the Assessing Officer, after enquiry, is satisfied that the joint property has been partitioned as a whole among the various members in definite portions, he shall record an order to that effect and shall make assessments on the H.U.F. for that assessment year as well as for any earlier year/s. Every member of the family shall be liable jointly and severally for the tax assessed on the net wealth of the family.

Where the partition has taken place during the previous year prior to the valuation date, the family as such shall not be liable for the tax after the partition but each member shall be liable to pay tax on his net-wealth.

Where the Assessing Officer is not satisfied about the partition of the family, he may declare that the family shall be deemed to continue to be a H.U.F. However, if a member gets out of it after taking his share of the joint property, the reduced family shall be liable to be taxed as a unit in respect of the diminished net wealth.

(4) Assessment after Partial Partition of a Hindu Undivided Family (Section 20A)

Where a partial partition has taken place after the 31st day of December, 1978, among the members of a Hindu undivided family hitherto assessed as undivided, such family shall continue to be liable to be assessed under this Act as if no such partial partition had taken place, and each member or group of members of such family shall be jointly and severally liable for any tax, penalty, interest, fine or other sum payable under this Act by the family in respect of any period, whether before or after such partial partition. Partial partition is no partition after the above date. However, the several liability of any member or group of members aforesaid shall be computed according to the portion of the joint family property allotted to him or it at such partial partition.

'Partial partition' means a partition which is partial as regards the persons constituting the family or the properties belonging to the family, or both.

(5) Assessment of Charitable Trusts (Section 21A)

Where any property is held under trust for any public purpose of a charitable or religious nature in India and (i) any part of such property or any income of the trust is used or applied; or (ii) any part of the income of the trust, being a trust created on or after 1.4.1962, enures directly or indirectly for the benefit of (a) the author of the trust or the founder of the institution; or (b) a person who has made substantial contribution to the trust; or (c) where the author or founder is a H.U.F., a member of the family; or (d) any trustee of the trust or manager of the institution; (e) any relative of the author, founder person, member, trustee or manager or member of H.U.F.; or (f) concern in which any of the person referred to in clauses (a), (b), (c), (d) and (e) has substantial interest, for any period during the previous year, such a trust institution shall be liable to pay wealth-tax on the value of the entire property. Wealth tax is also leviable in case any funds of the trust are invested or deposited or any shares in a company are held by the trust in contravention of the provision of Section 13(1)(d) of Income-tax Act, 1961. However, in the case of a trust created before 1.4.1962, the provisions of clause (i) shall not apply to the use of any part of such property or income of the trust for the benefit of person referred to in (a) to (f) above, if such use or application is by way of compliance with a mandatory term of the trust.

Wealth-tax for the purposes of this section shall be leviable upon, and recoverable from the trustee or manager (by whatever name called) in the like manner and to the same extent as if the property were held by an individual who is a citizen of India and resident in India for the purposes of this Act.

(6) Assessment of an Association of Persons (Section 21AA)

Where there is an "association of persons" other than a company or a co-operative society "or society registered under the Societies Registration Act, 1860 (21 of 1860) or under any law corresponding to that Act in force in any part of India" in which the shares of individual members are indeterminate on the date of its formation or any time thereafter, Wealth-tax will be levied upon and recovered from such association in the same manner and to the same extent as is leviable upon an individual resident citizen for the purposes of the Act.

Where any business or profession carried on by such association has been discontinued or the association is dissolved, the Assessing Officer shall make an assessment of the net wealth of such association as if no discontinuance or dissolution had taken place.

Every person who was, at the time of such discontinuance or dissolution, a member of the association of persons, and the legal representative of any such person who is deceased, shall be jointly and severally liable for the amount of tax, penalty or other sum payable, and all the provisions of this Act, so far as may be, shall apply to any such assessment or imposition of penalty or other sum.

(7) Assessment of Persons Residing outside India (Section 22)

Where the person liable to wealth-tax resides outside India, the tax may be levied upon and collected from his agent and his agent shall be deemed to be the assessee in respect of such tax. Any of the following persons may be appointed by the Assessing Officer as the agent of the person residing outside India after giving him a notice and an opportunity of being heard:

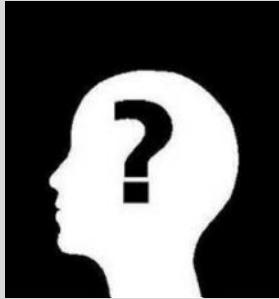
- (i) an employee of the person resident outside India;
- (ii) a person through whom he received any income, profit or gain;
- (iii) a person who is in possession or custody of any asset of a non-resident and upon whom the Assessing Officer has caused a notice to be served of his intention of treating him as the agent of such person.

The agent is entitled to recover the amount so paid from the person on whose behalf it is paid or to retain out of any money that may be in his possession or may come to him in the capacity of an agent.

Any agent or any person, who apprehends that he may be assessed as an agent of an outsider, he may retain out of any money payable by him to the principal, a sum equal to the estimated Wealth-tax liability. In the case of disagreement regarding the amount to be so retained, the agent may secure a certificate from the Assessing Officer stating the amount to be so retained. If the agent fails to retain the amount, he runs the risk of having to pay the wealth-tax out of his own pocket.

In the final settlement, the amount recoverable from the agent cannot exceed the amount specified in the certificate. However, the Assessing Officer can realise the excess out of any additional assets of the principal in the hands of the agent or recover it from any assets of the outsider that may at any time come within India.

Test Your Knowledge



5. The Hindu undivided family is the owner of the properties in an imitable estate.

- True
- False

PAYMENT AND RECOVERY OF WEALTH-TAX

(1) Notice of Demand (Section 30)

After an order has been made under this Act imposing any tax, interest, penalty, fine or any other sum, the Assessing Officer shall serve upon the assessee a notice of demand in the prescribed form specifying the sum so payable. According to Rule 4 of the Wealth-tax Rules the notice of demand shall be in Form C.

Any failure on the part of the Assessing Officer to comply with the requirements of Rule 4 in regard to the particulars therein specified, or any failure on the part of the Wealth-tax Officer to serve the notice is required by this section will invalidate the subsequent proceeding in recovery.

Whether fresh Notice of Demand is necessary after an order on appeal or other proceedings?

The answer is: No such notice is necessary. But if the result of the appellate or other proceedings is to reduce the original assessment, another notice is necessary.

Payment (Section 31)

The amount demanded shall be paid within 30 days of the service of the notice at the place and to the person mentioned in the notice. However, if the Assessing Officer has reason to believe that if the period of full 30 days is allowed to the assessee, it will be detrimental to the revenue, he may, with the previous approval of the Joint Commissioner, reduce period for the payment of the sum demanded.

Section 29A also provides that the Wealth-tax, as assessed, is payable though a reference has been made to the High Court or the Supreme Court. The provision implies that mere pendency of reference will not amount to a stay for recovery of demand.

If the demanded amount is not paid within 30 days or such lesser period, as may be prescribed by the Assessing Officer, the assessee shall be liable to pay simple interest @1% for every month or part of month for the period of default, i.e., the next day of the last date for payment, to the actual date of payment. According to Rule 12 the period and the amount in respect of which the interest is to be calculated shall be rounded off.

The rules regarding rounding off are as under:

- (i) where interest is to be calculated on annual basis, the period for which such interest is to be calculated shall be rounded off to a whole month or months and for this purpose any fraction of a month shall be ignored; and the period so rounded off shall be deemed to be the period in respect of which the interest is to be calculated;
- (ii) where the interest is to be calculated for every month or part of a month comprised in a period, any fraction of a month shall be deemed to be a full month and the interest shall be so calculated;
- (iii) the amount in respect of which the interest is to be calculated shall be rounded off to the nearest multiple of one hundred rupees and for this purpose any fraction of one hundred rupees shall be ignored; and the amount so rounded off shall be deemed to be the amount in respect of which the interest is to be calculated.

Where, as a result of an order under appeal the amount on which interest was payable had been reduced, the interest shall be reduced accordingly and the excess interest paid, if any, shall be refunded. And, in respect of any period commencing on or after 7.9.2003, the interest for the period falling after that date shall be calculated @1% for every month or part of the month.

On an application made by the assessee before the expiry of the due date for payment, the Assessing Officer may extend the time for payment or allow the payment by instalments subject to such conditions as he may think fit to impose. If the assessee fails to pay the amount within the time allowed, he shall be deemed to be in default. Further in case of payment by instalments where the assessee commits any default in paying any one of the instalments within the time fixed, the assessee shall be deemed to be in default as to the whole amount due on that date and the other instalment or instalments shall be deemed to have been due on the same date as the instalment actually in default.

Where an assessee has presented an appeal to the commissioner (Appeals), the Assessing Officer may treat the assessee as not being in default in respect of the amount in dispute in the appeal so long as the appeal remains undisposed of. The assessee shall not be deemed to be in default where he has been assessed in respect of assets located in a country outside India, the laws of which prohibit or restrict the remittance of money to India. He shall not be deemed to be in default in respect of that part of the tax only which is attributable to the assets in that country and until the prohibition or restriction of remittance is removed. But, as soon as restriction on remittance is removed, the assessee must make the payment within the specified time, failing which he would be treated as assessee in default.

Mode of Recovery (Section 32)

The provisions relating to the mode of recovery of Income tax apply also to the recovery of Wealth-tax.

(2) Liability of Transferees of Properties (Section 33)

If an individual transfers assets to any of the persons mentioned in Section 4 (i.e., to spouse to a person or association of persons for the benefit of his or her spouse etc.) the transferred assets are included in the net wealth of transferor and he would be assessed to tax in respect thereof. Normally, as a general rule a transferee of property is not liable to pay tax due by the transferor in respect of a transferred asset but Section 33 provides that after issuing a notice of demand, the portion of the tax attributable to the transferred asset (on a pro rata basis) may be recovered from the transferee. If the transferred asset is held jointly by more than one persons, they shall be jointly and severally liable to pay the tax. If the transferee fails to pay the tax demanded from him, he shall be deemed in default and all the provisions relating to recovery shall apply accordingly.

REFUNDS (SECTION 34A)

Where a refund of any amount becomes due to the assessee, as a result of an appeal or other proceedings

(reference, rectification of mistake or revision) the Assessing Officer shall refund the amount to the assessee without his having to make any claim in that behalf. However, where, by the order aforesaid, an assessment is set aside or cancelled and an order of fresh assessment is directed to be made, the refund, if any shall become due only on the making of such fresh assessment. And, if the assessment is annulled, the refund shall become due only of the amount, if any, of the tax paid in excess of the tax chargeable on the net wealth returned by the assessee.

Further, where refund of any amount becomes due to the assessee as a result of an order of assessment, whether pursuant to the filing of a return of wealth within or after due date/amendment or in response to a notice etc. and the Assessing Officer is of the opinion that in view of the matter being the subject-matter of an appeal or further proceeding or any other proceeding being pending, the grant of refund is likely to adversely affect the revenue, he may, with the previous approval of the Chief Commissioner or Commissioner, withhold the refund till such time as determined by the Chief Commissioner or Commissioner.

Where a refund is found due to any person, the Assessing Officer, the Deputy Commissioner (Appeals), or Commissioner (Appeals) or Chief Commissioner, or Commissioner after giving a written intimation to the assessee, may, in lieu of payment, set off the amount of refund against the amount, if any, remaining payable under this Act by the assessee.

With effect from 7.9.2003, as per Sub-section (4B), where any refund becomes due to the assessee under the Wealth-tax Act, he is entitled to receive simple interest thereon @ 1/2 per cent for every month or part of a month from the date/s of payment of the tax or penalty to the date of grant of refund. In the case of delay in the proceedings, attributable to the assessee, the period of delay shall be excluded from the period for which he is entitled to the interest. Further, in the case of reduction or increase in the amount on which interest is payable, as a result of an order of assessment or the orders by Appellate authorities in appeal, revision, or order of the Wealth-tax Settlement Commission, the interest shall also be correspondingly increased or reduced. In the case where the interest is reduced, the Assessing Officer shall issue a notice of demand to the assessee, calling for payment of the excess interest paid.

RECTIFICATION OF MISTAKES (SECTION 35)

With a view to rectify any mistake apparent from the record, the Assessing Officer, a Wealth-tax authority, the Valuation Officer, the Joint Director, Joint Commissioner, Director, Commissioner, Commissioner (Appeals), Appellate Tribunal may amend their respective orders either on his/its own motion or when it is brought to notice either by the assessee or where the authority concerned is the Valuation Officer or the Commissioner (Appeals) or the Appellate Tribunal, by the Assessing Officer.

If the amendment enhances the assessment or reduces a refund, the authority concerned cannot do so without giving a notice to the assessee of its intention to do so and allowing him a reasonable opportunity of being heard.

If the assessee pays any amount of tax, penalty or interest in dispute within 6 months from the date of order passed in the first appeal or revision, the sum so paid would be allowed as a permissible deduction. This deduction would be allowed as a deemed rectification of mistake.

The order of amendment shall be passed in writing by the authority concerned and where it has the effect of enhancing the assessment or reducing a refund already made, the Assessing Officer shall serve on the assessee a notice of demand specifying the sum payable.

The time limit for rectification is four years from the end of the financial year in which the order was passed in the first appeal or revision and in other cases it is four years from the end of the financial year in which the order sought to be amended was passed.

SETTLEMENT OF CASES

The provisions regarding settlement of cases under this Act are the same as those of the Income-tax Act. Therefore, the students are advised to study these provisions from the Lesson 12.

APPEAL TO COMMISSIONER (APPEALS) [SECTION 23(1A) & (B)]

Any person who is not satisfied by any of the following orders may file an appeal to the Commissioner (Appeals), in the prescribed form and verified in the prescribed manner:

- (1) objecting to the amount of the Net wealth/amount of Wealth-tax determined to be payable or denying his liability to be assessed under this Act. The above is subject to the condition that the total wealth determined in assessment made under Section 16 exceeds ₹ 15 lakhs;
- (2) objecting to the penalty imposed under Section 18(1), with the previous approval of the Deputy Commissioner, under Section 18(3); or
- (3) objecting to any assessment or order referred to in the preceding items (i) to (viii), where such assessment or order has been made by the Deputy Commissioner in exercise of the powers or functions conferred on or assigned to him under Section 8 or 11; or
- (4) objecting to any penalty imposed by the Joint Director or Joint Commissioner under Section 18A; or
- (5) objecting to an order made by an Assessing Officer in case of such persons or classes of persons as the Board may, having regard to the nature of the cases, the complexities involved and other relevant considerations, direct.

Sub-Section (1B), further provides that notwithstanding anything contained in Sub-section (1), the Board or the Director General or the Chief Commissioner or Commissioner, if so authorised by the Board may, by order in writing, transfer any appeal which is pending before a Deputy Commissioner (Appeals) and any matter arising out of or connected with such appeal and which is so pending, to the Commissioner (Appeals) if the Board or, as the case may be, the Director General, the Chief Commissioner or Commissioner (at the request of the appellant or otherwise) is satisfied that it is necessary or expedient so to do having regard to the nature of the case, the complexities involved and other relevant considerations and the Commissioner (Appeals) may proceed with such appeal or matter from the stage at which it was before it was so transferred:

Provided that the appellant may demand that before proceeding further with the appeal or matter, the previous proceeding or any part thereof be re-opened or that he be re-heard.

Appealable orders before Commissioner (Appeals) [Section 23A]

- (1) Any person may appeal to the Commissioner (Appeals) against the assessment or order:
 - (a) objecting to the amount of net wealth determined under this Act.
 - (b) objecting to the amount of Wealth Tax determined as payable by him under this Act.
 - (c) denying his liability to be assessed under this Act.
 - (d) objecting to any penalty imposed by the assessing officer under Section 18 or Section 18A.
 - (e) objecting to any order of the assessing officer under Sub-section (2) of Section 20.
 - (f) objecting to any penalty imposed by the assessing officer under the provision of Section 221 of the Income-tax Act as applied under Section 32 for the purposes of Wealth Tax.
 - (g) objecting to any order made by the assessing officer under Section 22 treating him as agent of a person residing outside India.

- (h) objecting to any order of the assessing officer under Section 35 having the effect of enhancing the assessment or reducing a refund or refusing to allow the claim made by the assessee under the said section, or
- (i) objecting to any order of the Valuation Officer under Section 35 having the effect of enhancing the valuation of any asset or refusing to allow the claim made by the assessee under the said section, or
- (j) objecting to any penalty imposed by the Deputy Director or Deputy Commissioner under Section 18A.

The application in duplicate, has to be in the prescribed form (form E) and verified in the prescribed manner and on payment of a fee of two hundred and fifty rupees.

Explanation: For the purpose of this sub-section where on or before 1st day of October, 1998, the post of Deputy Commissioner has been redesignated as Joint Commissioner and the post of Deputy Director has been redesignated as Joint Director the reference in this sub-section for "Deputy Commissioner" and "Deputy Director" shall be substituted by "Joint Commissioner" and 'Joint Director" respectively.

(2) Every appeal pending before the Deputy Commissioner (Appeals), immediately before the appointed day and any matter arising out of or connected with such appeal shall stand transferred to the Commissioner (Appeals) and he may proceed with such appeals or matter from the stage on which it was on that day. However, the appellant may demand that before proceeding further with the appeal or matter, the previous proceedings or any part thereof be reopened or that he be reheard. Appointed day means the day appointed under Section 246A of the Income-tax Act.

(3) An appeal shall be presented when thirty days of the receipt of the notice of demand relating to the assessment or penalty objected to or the day on which any order objected to is communicated to him. The Commissioner (Appeals) may, however, admit an appeal after the expiry of the aforesaid period, if he is satisfied that the appellant had sufficient cause for not presenting the appeal within that period.

Section 23A further provides that appeal is admitted only if the assessee has paid the tax due on the net wealth returned by him.

In every appeal, the Commissioner (Appeals), where it is possible, may hear and decide such appeal within a period of one year from the end of the financial year in which such appeal is filed under Section 23A(1).

The order of Commissioner (Appeals) shall be in writing and shall state the points for determining the decision thereof and reasons for the decision and a copy of every order so passed shall be forwarded to the appellant and the Chief Commissioner or Commissioner.

Order passed by the Appellate Tribunal on appeal shall be final except as provided in Section 27 or Section 27A.

APPEAL TO THE APPELLATE TRIBUNAL (SECTION 24)

Where the assessee is not satisfied by any of the following orders of the Commissioner (Appeals), he may file an appeal to the Appellate Tribunal within sixty days of the date on which the order is communicated to him:

- (1) penalty under Section 18; or
- (2) penalty under Section 18A; or
- (3) order passed by the Commissioner (Appeals) under Section 23 or Section 23A; or
- (4) imposing a fine under Section 37(2).

In the same way, if the Commissioner is not satisfied by the order of the Commissioner (Appeals), he may direct the Assessing Officer to appeal to the Appellate Tribunal against the order. The appeal shall be filed in the prescribed Form F and within 60 days of the date of which the order sought to be appealed against is communicated to the Commissioner. If the appeal is filed by the assessee, it shall accompany a fee of ₹

1000. However, for appeal not relatable to net wealth as computed by the Assessing Officer, fee is ₹ five hundred.

After receiving the application from the aggrieved party in form F, the Appellate Tribunal shall issue a notice to the other party that an appeal against the order has been preferred. The other party may file a memorandum of cross objections in the prescribed Form G against the order within 30 days of the receipt of the notice. The memorandum of cross objections shall be treated as if it were an appeal presented by the other party. If the assessee or the Assessing Officer, as the case may be, fails to file the appeal or memorandum of cross objection in the prescribed time, the Appellate Tribunal may admit it after the expiry of relevant period if it is satisfied that there was sufficient cause for not presenting it within the prescribed time.

The Appellate Tribunal may, after giving both the parties to the appeal an opportunity of being heard, pass such order as it deems fit. However, it is not empowered to enhance the assessment or penalty without giving an opportunity to the assessee showing cause against such assessment.

By amendment in this section Finance Act, 1999 has provided that in every appeal the Appellate Tribunal, where it is possible, may hear and decide such appeal within a period of four years from the end of the financial year in which such appeal is filed. It is further provided that the cost of any appeal to the Appellate Tribunal shall be at the discretion of that Tribunal.

A copy of the order passed by the Tribunal shall be forwarded to the assessee and the Commissioner. The decision of the Tribunal regarding the facts of the case shall be final.

REVISIONS OF ORDERS BY COMMISSIONER (SECTION 25)

The Commissioner can revise the orders passed by any authority subordinate to him under two circumstances:

- (1) In the interest of assessee.
- (2) In the interest of the revenue.

The Commissioner, either on his own motion or on an application by the assessee for revision, can call for the record of any proceeding under this Act which has been conducted by any authority subordinate to him (including the Appellate Assistant Commissioner). After making such enquiry as may be necessary, the Commissioner may pass such orders as he thinks fit. However, the order cannot be prejudicial to the assessee. The Commissioner is not empowered to revise any order on his own motion if a period of more than one year has expired from the date of the order sought to be revised. If the application is made by the assessee for revision, it must be accompanied by a fee of ₹ 25 and it must be made within one year from the date of the order sought to be revised or within such further period as the Commissioner may think fit allow on being satisfied that the assessee was prevented by sufficient cause from making the application within the prescribed time. If the Commissioner refuses to interfere, it shall not be deemed an order prejudicial to the assessee. Further, the Commissioner shall not revise any order in the following cases:

- (i) where an appeal against the order lies to the Commissioner (Appeals) or to the Appellate Tribunal, the time within which such appeal can be made has not expired or in the case of an appeal to the Tribunal, the assessee has not waived his right of appeal.
- (ii) where the order is the subject of an appeal before the Commissioner (Appeals) or the Tribunal.

The Commissioner on his own motion, may call for and examine the record of any proceeding under this Act and if he considers that any order passed by the Assessing Officer is prejudicial to the interests of the revenue, he may, after giving the assessee a reasonable opportunity of being heard and after making or causing to be made the necessary enquiries pass such order as the circumstances of the case justify. At the time of revision, he can enhance or modify the assessment or cancel it and direct for a fresh assessment. However, no order shall be made after the expiry of 2 years from the date of the order sought to be revised.

In respect of any application made on or after 1st October, 1998, it shall be obligatory on the Commissioner to pass an order within a period of one year from the end of financial year in which such application is made by the assessee for revision. But, an order in revision can be passed by the Commissioner at any time, in the case of any order which has been passed in consequence of or to give effect to any finding or direction contained in an order of the Tribunal, the High Court or the Supreme Court. Further in computing the period of two years, the time taken in giving an opportunity to the assessee to be re-heard (under Section 39) and any period during which proceeding under this section is stayed by an order of injunction of any court shall be excluded.

REFERENCE TO THE HIGH COURT (SECTIONS 27)

Section 27 provides for a reference on a question of law to the High Court. The assessee or the Commissioner may, within 60 days of the date on which he is served with an order of the Appellate Tribunal or the Commissioner [under Section 24 or 25 by application in the prescribed form 'H' require the Appellate Tribunal to refer to the High Court any question of law arising out of such order. A question will be said to arise out of the Tribunal's order only if it has been raised before or decide by the Tribunal.

However, no application shall be made to the Appellate Tribunal to make a reference to the High Court on or after 1st day of June 1999 as provided by Finance Act, 1999.

The Tribunal may accept an application within 30 days even after the expiry of the prescribed time (60 days) if it satisfied that the applicant was prevented by sufficient cause from presenting the application within time.

If the application is made by the assessee for reference of the case to the High Court, it must be accompanied by a fee of ₹ 200.

On receipt of an application for reference, the Tribunal shall state the case to the High Court within 120 days of the receipt of the application. Where the Tribunal refuses to state the case either on the ground that no question of law arises from its order, or that the application is time barred, the aggrieved party may apply to the High Court against the refusal by the Tribunal to state the case to it. In this case the application must be presented within 90 days from the date on which he is served with a notice of refusal or rejection. The High Court may admit an appeal even after the expiry of the period of one hundred and twenty days if it is satisfied that there was sufficient cause for not filing the same within that period.

If the court is not satisfied with the decision of the Tribunal, it may require the Tribunal to state the case and on receipt of such requisition the Tribunal shall state the case.

Where the assessee is satisfied on the Tribunal's refusal to state to the case on the ground that no question of law arises, he may, within 30 days from the date on which he receives notice of refusal, withdraw his application and if he does so, the fees paid by him shall be refunded to him.

Where the Tribunal is of the opinion that on account of conflict of decisions between the different High Courts in respect of any particular question of law, it is expedient to refer the question to the Supreme Court, it may refer the question to the Supreme Court through its President.

The Tribunal shall state the facts of the case, its own finding and the questions of law which are required for reference. If the Court finds that the statement does not set out all the points which might have been referred, it may send the case back for making such necessary modifications as may be directed by the Court.

The court, upon hearing the reference, shall decide the question of law raised therein and deliver the judgement containing the grounds on which decision is founded. A copy of the judgement shall be sent under seal of the court and the signature of the Registrar to the Tribunal. The Tribunal shall pass such orders as are necessary for disposing of the case conformably to such judgement.

The costs of the reference to the court excluding the fee for making the reference shall be in the discretion of the court.

APPEAL TO HIGH COURT (SECTION 27A)

Section 27A has been inserted by Finance (No. 2) Act, 1998 to provide that an appeal shall lie to the High Court from every order passed on an appeal by Appellate Tribunal if the High Court is satisfied that the case involves a substantial question of law. An appeal can be made within 120 days of the date of service of relevant order.

The High Court may admit an appeal even after the expiry of the period of one hundred and twenty days if it is satisfied that there was sufficient cause for not filing the same within that period.

In an appeal under the new section, the Memorandum of Appeal shall precisely state the substantial question of law involved in the appeal.

Where the High Court is satisfied that a substantial question of law is involved in any case, it shall formulate the question. The appeal shall be heard only on the question so formulated and the respondent shall, at a hearing of the appeal, be allowed to argue such question. However, nothing in this section shall be deemed to take away or abridge the power of the court to hear for reasons to be recorded, appeal in any other substantial question of law not formulated by it, if it is satisfied that the case involves such question.

The High Court decides the formulated question of law and deliver judgement containing the grounds on which such decision is founded. It may also award costs.

The assessing officer is required to give effect to the order of the High Court on the basis of a certified copy of the judgement delivered. In the case of appeal to High Court the provisions of the Code of Civil Procedure, 1908 apply.

Section 28 - Hearing by High Court

The case referred to or appeal filed to in the High Court shall be heard by a Bench of not less than two judges, the case is to be decided unanimously or where they differ, according to the opinion of the majority. Where the number of judges hearing the case is even and there is no majority in forming an opinion on a point the case shall be heard on that point only by one or more other judges of the Court. Such point shall then be decided according to the opinion of the majority of the judges who have heard the case, including those who first heard it.

APPEAL TO SUPREME COURT (SECTION 29)

An appeal may lie to the Supreme Court from any judgement of a High Court provided the High Court certifies the case to be a fit one for appeal to the Supreme Court. The High Court grants such certificate only if a substantial question of law is involved in the case or the question is likely to occur in future or if the question is otherwise of great public or private importance, if, however, the High Court decide not to give such a certificate, then the aggrieved party, may make an application to the Supreme Court under Article 136 of the Constitution of India.

The Supreme Court, after hearing the appeal, may either affirm, vary or reverse the decision of the High Court. Accordingly, the decision of the supreme Court shall be sent to the Tribunal which shall pass such orders as are necessary for disposing of the case in conformity with such judgement.

PENALTIES UNDER THE WEALTH-TAX ACT

The non-compliance with the various provisions of Wealth-tax Act, Sections 15B(3), 18, 18A and 32 provide for the levy of penalty on the assessee. In addition, Sections 35A to 35L contain provisions under which an assessee might be prosecuted for certain offences under the Wealth-tax Act. The various terms of penalty are described below:

(1) Penalties Imposable under Wealth-tax Act

The various items of penalties imposable and prosecutions under the Wealth-tax Act, are as under:

Section	Nature of default	Penalty/Fine
(A)	(B)	(C)
15B(3)	Failure to pay tax or interest payable on self-assessment	Liable for penalty by deeming assessee to be in default (Not exceeding 100% of tax in arrears)
18(1)(ii)	Failure to comply with notice under section 16(2) or (4) without reasonable cause	Minimum : ₹ 1,000 for each failure Maximum : ₹ 25,000 for each failure
18(1)(iii)	Concealment of wealth	Minimum : 100% of tax sought to be avoided Maximum : 500% of tax sought to be avoided
18A(1)(a), (b) and (c)	Failure to answer questions (i) legally bound or (ii) sign statements legally required or (iii) comply with summons under section 37(1) without reasonable cause.	Minimum : ₹ 500 for each failure/default Maximum : ₹ 10,000 for each failure/default
18A(2)	Failure to furnish in due time statement/ information required under section 38 without reasonable cause.	Minimum : ₹ 100 for every day of default Maximum : ₹ 200 for every day of default
32	Committing default in payment of tax	Not exceeding 100 per cent of tax in arrears

PROSECUTIONS

35A(1)	Wilful attempt to evade tax, penalty or interest: in case amount sought to be evaded exceeds ₹ 1,00,000 in any other case	6 months rigorous imprisonment which may extend to 7 years and fine without prejudice to penalty imposable under any other provision of the Act. 3 months rigorous imprisonment which may extend to 3 years and fine without prejudice to penalty imposable under any other provision of the Act.
35A(2)	Wilful attempt to evade payment of tax, penalty or interest	3 months rigorous imprisonment which may extend to 3 years and fine without prejudice to penalty imposable under any other provision of the Act.
35B	Wilful failure to furnish in due time return of wealth in terms of section 14(1) or 14(2) or 17 (1)- (a) in case where tax sought to be evaded exceeds ₹ 1,00,000 (b) in any other case	6 months rigorous imprisonment which may extend to 7 years and fine 3 months rigorous imprisonment which may extend to 3 years and fine

	<i>Note:</i> Prosecution is not to be resorted to in cases where return is furnished before end of assessment year or tax determined on regular assessment does not exceed ₹ 3,000	
35C	Wilful failure to produce accounts/records in terms of section 16(4)	Up to 1 year rigorous imprisonment or fine between ₹ 4 and ₹ 10 for every day of default or with both
35D	Filing of false statement in verification (other than under Section 35AB regarding registration of valuers)/delivering false statement- <ul style="list-style-type: none"> (a) in case where tax sought to be evaded exceeds ₹ 1,00,000 (b) in any other case 	6 months rigorous imprisonment which may extend to 7 years and fine 3 months rigorous imprisonment which may extend to 3 years and fine
35E	Making false statement in verification mentioned in section 35AB	Imprisonment up to 6 months or fine or both
35EE	Failure without reasonable cause, to furnish particulars under section 35ACC regarding intimation by registered valuer of his conviction of any offence	Rigorous imprisonment up to 2 years and fine
35EEE	Making contravention of order made under section 37A/(3A)	Up to 2 years rigorous imprisonment and fine.
35F	Abetting or inducing another person to make and deliver false accounts, statement or declaration relating to net wealth chargeable to tax: <ul style="list-style-type: none"> (a) in case where tax, etc. sought to be evaded exceeds ₹ 1,00,000 (b) in any other case 	6 months rigorous imprisonment which may extend to 7 years and fine 3 months rigorous imprisonment which may extend to 3 years and fine
35G	Second and subsequent offences under sections 35A(1), 35B, 35D or 35F	6 months rigorous imprisonment which may extend to 7 years and with fine

*Note: Prosecution has to be initiated with the previous sanction of specified wealth-tax authorities who have also power to compound offences vide section 35

The student should also note that by virtue of the provisions of Sections 34A and 37C, as amended : (a) interest @ for every month or part of the month on the refund due on the assessee is payable to him by the Wealth-tax authorities for the period specified in Section 34A, and (b) interest @ 15% per annum is payable by the Central Government on the surplus remaining after the application of the assessee's assets by the assessing authorities towards recovery of the Wealth-tax due from him (for the period specified in Section 37C).

Failure to furnish return on time is not a continuing default. The quantum of penalty will be determined in accordance

with the provisions as they stood on the date on which the return was due. [C.W.T. v. Mor Shrikant Ramnaryan. (1984) 147 I.T.R. 412].

Section 18 provides for penalty for failure to furnish returns to comply with notice and concealment of assets etc. If the Assessing Officer, Commissioner (Appeals), Chief Commissioner or Commissioner or Appellate Tribunal, in the course of any proceeding under the Wealth-tax Act is satisfied that any person has failed to: (i) comply with the notice under Sub-sections (2) or (4) of Section 16, or (ii) has concealed the particulars of any assets or furnished inadequate particulars of any assets or debts, he or it may, by an order in writing, direct that such person shall pay, in the case of (i) hereinabove, in addition to the amount of Wealth-tax payable by him, the penalty which may be minimum of ₹ 1,000 and maximum ₹ 25,000. The penalty payable in the case of (ii) hereinabove is minimum the amount of tax sought to be evaded by reason of concealment of the particulars of any assets or furnishing of inadequate particulars in respect of any assets or funds. The maximum penalty imposable in this case is five times the amount of tax sought to be evaded. In the case of non-compliance with the notice under Section 16(2) or (4), the penalty is not imposable if the person proves that there was reasonable cause for the failure referred to thereunder.

Explanation 3 to Sub-section (1) provides that where any person, who is not previously assessed under the Wealth-tax Act fails, without reasonable cause, to furnish within the time limit for completion of assessment (Section 17A), the return of his net wealth in respect of assessment year 1989-90 onwards and till the expiry of the time limit relevant thereto (two years) no notice has been issued to him by the assessing authority and the concerned assessing authority is satisfied that in respect of such assessment year, such person is assessable for Wealth-tax, he shall be deemed to have concealed the particulars of his assets or furnished inadequate particulars of any asset or debt in respect of such assessment year, even if such person has furnished the return of his net wealth at any time after the expiry of the applicable periods under Section 17.

In this case, the amount of 'tax sought to be evaded' means the tax assessed on the net wealth. In any other case, it means the difference between the tax on the net wealth assessed and the tax chargeable on the wealth disclosed by the assessee.

Further, in the case of failure of an assessee to offer an explanation in respect of any facts material to the computation of his net wealth or the explanation offered by him being found by the concerned assessing authority to be false or where he is not able to substantiate his explanation and fails to prove the bona fides of such explanation, the consequential deduction or disallowance in computing his net wealth shall be deemed to represent the value of the assets in respect of which the particulars have been concealed.*

Any bullion, money, jewellery or other valuable article or thing found in the course of search and claimed by the assessee as forming or representing parts of his net wealth are deemed to have been concealed by him if the assets have not been declared in the return of wealth furnished before the date of search for the valuation date falling before or after the date of search unless the assets are recorded either before the date of search or specified in the books of account maintained by him or disclosed to the Commissioner before the date of search or the assessee declares such assets in the course of search, specifies the manner of acquisition thereof and pays tax and penalty thereon.

Explanation 6 clarifies that the circumstance where any additional tax is charged as a consequence of rectification of arithmetical error, exemptions or deductions allowed/disallowed on the basis of the information available in the return of wealth does not tantamount to concealment.

Sub-section (3) makes the prior approval by the Joint Commissioner compulsory for the following cases : (i) where the penalty exceeds ₹ 10,000 and the concerned assessing authority is the Income-tax Officer; (ii) where the penalty exceeds ₹ 20,000 and the concerned assessing authority is the Assistant Commissioner or Deputy Commissioner.

Sub-section (5) lays down that no order imposing the penalty under this Section shall be passed in a case where the assessment to which the proceedings for imposition of penalty relate is the subject matter of an appeal under Section 23 or 24; after the expiry of the financial year in which the proceedings, in the course of which

action for imposition of penalty has been initiated, are completed or 6 months from the end of the month in which the order of assessing authority i.e. the Commissioner (Appeals) or ITAT is received by the Chief Commissioner or Commissioner whichever is later. Where the relevant assessment is subject matter of revision under

Section 25(2), the order imposing penalty shall not be passed after the expiry of six months from the end of the month in which such order or revision is passed. In any other case, the penalty order cannot be passed after the expiry of the financial year in which the proceedings in course of which action for imposition of penalty has been initiated, are completed or six months from the end of the year in which action for imposition of penalty is initiated, whichever period expires later.

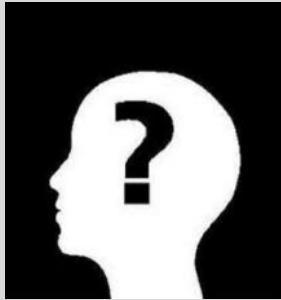
In computing the above periods of limitation, the period during which immunity is granted under Section 22H; the time taken in giving an opportunity to the assessee to be reheard under Section 39 and the period during which a proceeding for levy of penalty is stayed by an order or injunction of any court shall not be taken into account.

(2) Failure to Pay Tax (Section 31)

When an assessee fails to pay tax demanded of him during the prescribed time (30 days), he shall be liable by way of penalty, to pay such amount as the Assessing Officer may direct and in case of continuing default, such other sum as directed from time to time. However, the total amount of penalty can not exceed the amount of tax in arrears.

Where the Assessing Officer is satisfied that the default was for good and sufficient reasons, no penalty shall be levied on the assessee.

Test your knowledge



6. What is the minimum and maximum amount of penalty payable if a person has failed to pay the amount of Wealth- tax?

- (a) 1,000 minimum and 25,000 maximum
- (b) 10,000 minimum and 20,000 maximum
- (c) 500 minimum and 10,000 maximum
- (d) 5,000 minimum and 15,000 maximum

POWER TO REDUCE OR WAIVE PENALTY (SECTION 18B)

The Commissioner is empowered to reduce or waive the amount of penalty imposed or imposable on an assessee either on his own motion or otherwise, in the following cases:

- (i) Concealment of the particulars of his wealth or furnishing of inaccurate particulars of assets or debts.

The Commissioner would reduce or waive the penalty subject to the following conditions :

- (i) in case of (i) above, the assessee has furnished particulars regarding the concealed wealth or particulars in respect of any asset or debt voluntarily and in good faith prior to the detection by the Assessing Officer of the concealment or inaccurate particulars of assets or debts.
- (ii) he has co-operated with the department in any enquiry relating to assessment.
- (iii) he has paid or made satisfactory arrangements for the payment of tax or interest payable in respect of the relevant assessment year.

Where the assessee conceals the particulars of his wealth and the amount of wealth so concealed for any one

of the relevant assessment years exceeds ₹ 5,00,000, the Commissioner cannot reduce or waive the penalty, without the previous approval of the Chief Commissioner or Director General. However, where the Commissioner has reduced or waived the penalty once in relation to one or more assessment years, the assessee shall not be entitled to any relief again for other assessment years.

Further, Section 18B(4) empowers the Commissioner to grant relief to an assessee on his application and after recording the reasons for doing so by (i) reducing or waiving every kind of penalty payable under the Wealth-tax Act, or (ii) staying or compounding recovery proceedings in respect thereof. This right should be exercised by the Commissioner in deserving cases which satisfy the following conditions:

- (i) if it is not done, it would cause genuine hardship to the assessee, and
- (ii) the assessee has co-operated in any inquiry relating to assessment or recovery proceedings.

An order of the Commissioner (under Section 18B) reducing or waiving the penalty shall be final and shall not be called into question before any court or any other authority.

OFFENCES AND PROSECUTIONS (SECTIONS 35A TO 35N)

There are certain lapses on the part of the assessee for which the wealth-tax authority at the instance of the Commissioner, may launch prosecution proceedings against him in the court. In that case the Magistrate (Metropolitan or first class) shall penalise the assessee and not the department. However, the Commissioner may, either before or after the institution of proceedings compound any offence.

The prosecution proceedings may be instituted against the defaulter assessee in various cases explained in the succeeding paragraph, other than these sections which are already discussed (Section 35A to Section 35G):

(1) Wilful Attempt to Evade Tax etc. (Section 35A)

If a person wilfully attempts to evade any tax, penalty, or interest or payment thereof, he shall be liable to pay penalty as well as prosecution as stated in the table under heading IX hereinbefore.

A wilful attempt to evade any tax, penalty or interest etc., or the payment thereof shall include a case where any person :

- (i) has, in his possession or control any books of account or documents containing a false entry or statement; or
- (ii) makes, or causes to be made, any false entry or statement in such books of account or documents; or
- (iii) wilfully omits, or causes to be omitted, any entry or statement in the books of account or documents; or
- (iv) causes any other circumstances to exist which will have the effect of enabling him to evade the tax, penalty or interest.

(2) Failure to Furnish Returns of Net Wealth (Section 35B)

If a person wilfully fails to furnish in due time the return of net wealth under Section 14(1) or 14(2) or 17(1), he shall be punishable with both penalty and prosecution. For details see the Table under heading IX hereinbefore.

However, a person shall not be proceeded against for failure to furnish in due time the return of net wealth under Section 14(1) in the following cases :

- (a) for any assessment year commencing prior to 1.4.1975;
- (b) for any assessment year commencing after 31.3.1975; if
 - (i) the return is furnished by him before the expiry of the assessment year; or

(ii) the tax payable by him, determined on regular assessment, does not exceed ₹ 3,000.

(3) Failure to Produce Accounts and Documents (Section 35C)

If a person wilfully fails to produce accounts, records and documents referred to in a notice issued under Section 16(4) on the date specified in the notice, he shall be punishable with rigorous imprisonment as well as fine. (See the Table under heading IX hereinbefore)

(4) False Statement in Verification (Section 35D)

If a person makes a statement in any verification (other than the registration of valuer) or delivers an account or statement which is false, and which he knows to be false or does not believe to be true, he shall be punishable with prosecution/penalty highlighted under heading IX hereinbefore.

(5) False Statement in Verification by Registered Valuers (Section 35E)

If a Registered Valuer makes a statement in verification which he either knows or believes to be false, or does not believe to be true, he shall be punishable with imprisonment for a term which may extend to 6 months or with fine or with both. (Also given in Table under heading IX hereinbefore.)

(6) Failure to furnish particulars under Section 34ACC (Section 35EE)

If a person referred to in Section 34ACC, i.e., a registered valuer, fails to intimate to the Board the particulars of conviction or finding referred to in the said section, he shall be punishable with rigorous imprisonment and also be liable to fine. But, if such person proves that there was reasonable cause or excuse for the said failure, he shall not be punishable. (For details see the Table under heading IX hereinbefore).

(7) Contravention of order made under Section 37A (Section 35EEE)

Section 35EEE, provides for punishment with rigorous imprisonment (See Table under heading IX) and also imposition of fine in the event of contravention of the provisions of Section 37A, second proviso to Sub-section (1) and sub-section (3A) [pertaining to orders of the Assessing Officer to assessee not to remove, part with or otherwise deal with the immovable properties, except with the previous permission of the concerned officer].

(8) Abetment of False Return, etc. (Section 35F)

If a person abets or induces any other person to make and deliver an account, statement or declaration relating to any net wealth chargeable to tax which is false and which he either knows to be false or does not believe to be true, or induces any person to evade tax, he shall be punishable with prosecution and fine specified under heading IX.

(9) Punishment for Second and Subsequent Offences (Section 35G)

If any person convicted of an offence mentioned in 1, 2, 4 and 7 above is again convicted of the same offence, he shall be punishable for the second and every subsequent offence with rigorous imprisonment for at least 6 months but which may extend to seven years and with fine.

(10) Offences by H.U.F. (Section 35H)

Where an offence under this Act has been committed by a H.U.F., the karta thereof shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly. However, if he proves that the offence was committed without his knowledge, or that he had exercised all due diligence to prevent the commission of such offence, he shall not be punished. Where it is proved that the offence has been committed with the consent or connivance of or is attributable to any neglect on the part of any member of the family, such

member shall be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

(11) Offences by companies (Section 35HA)

The Finance Act, 1992 has inserted this new Section 35HA with effect from the assessment year 1993-94. As companies have also been brought under the wealth tax net with effect from assessment year 1993-94 this new Section 35HA lays down the penalty where an offence has been committed by a company. Thus according to this section every person who at the time the offence was committed, was incharge of and was responsible to the company for the conduct of the business of the company as well as the company will be liable to be proceeded against and punished accordingly.

However, no such person shall be liable to any punishment if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence.

Further, this section also defines the term 'company' to include a firm and an association of persons or body of individuals whether incorporated or not.

W.e.f. 1.10.2004, where an offence has been committed by a Person, being a company and such offence is punishable with imprisonment and fine, then without prejudice to the aforesaid provisions such company shall be punishable with fine and every person referred to in sub-section (1) or the director, manager, secretary or other officer of the company referred to in sub-section (2), shall be liable to be proceeded against and punished in accordance with the provisions of this Act.

(12) Prosecutions to be at the instance of Chief Commissioner or Commissioner and power of Chief Commissioner to compound offences (Section 35-I)

A person shall not be proceeded against for an offence under the Wealth-tax Act, 1957 except with the previous approval of the Commissioner or Commissioner (Appeals). The Chief Commissioner/Director General have been empowered to issue such instructions/directions with regard to prosecution matters as they may deem fit. They have also been empowered to compound any offence either before or after the institution of proceedings.

(13) Certain offences to be non-cognizable (Section 35J)

Notwithstanding anything contained in the Code of Criminal Procedure, 1973, an offence punishable under Section 35A or Section 35B or Section 35D or

Section 35F shall be deemed to be non-cognizable within the meaning of that Code.

(14) Bar on Prosecution (Section 35K)

A person shall not be prosecuted for an offence under 1 and 4 above (Sections 35A and 35D) in relation to the assessment for an assessment year in respect of which the penalty imposed or imposable under Section 18(1)(iii) has been reduced or waived under Section 18B. Further, any statement made or account or other document produced by the offender before any wealth-tax authority, not being an Inspector of Income-tax, shall not be inadmissible as evidence for prosecution proceedings merely on the ground that it was made or produced in the belief that the penalty would be reduced or waived or the offence would be compounded.

(15) Jurisdiction of Courts (Section 35L)

No court inferior to that of a Metropolitan Magistrate or a Magistrate of the first class shall try any offence under this Act.

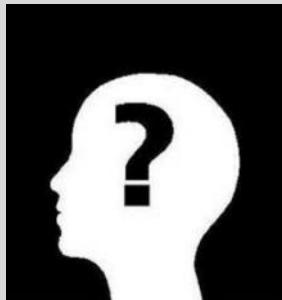
(16) Section 360 of the code of Criminal Procedure, 1973 and the Probation of Offenders Act, 1958 not to apply (Section 35M)

Nothing contained in Section 360 of the Code of Criminal Procedure, 1973, or in the Probation of Offenders Act, 1958, shall apply to a person convicted of an offence under this Act unless that person is under eighteen years of age.

(17) Immunity from Prosecution (Section 36A)

The Central Government may grant immunity to potential supplier of valuable information, data and evidence on the basis of which tax-evaded wealth may be discovered and due taxes, penalty, etc., recovered from the tax-evader concerned. Such immunity extends to prosecution for the offences and penalty under the Wealth-tax Act. However, if the person does not comply with the conditions on which the immunity was granted or willfully conceals anything or gives false evidence, the Government, after recording the reasons in writing for doing so, may withdraw the immunity granted. Then, the person may be tried for any offence and be liable to any penalty imposable under this Act.

Test Your Knowledge



7. Which of the following offences is considered under Section 35E?

- (a) Wilful Attempt to Evade Tax etc.
- (b) False Statement in Verification
- (c) Failure to Produce Accounts and Documents
- (d) False Statement in Verification by Registered Users

LESSON ROUND UP

- Wealth-tax is charged in respect of the net wealth of an assessee on the corresponding valuation date.
- The wealth tax is charged on the net wealth of an assessee. The rate to a particular assessee can be applied only when the following four ingredients are determined:
 - (a) The quantum of net wealth chargeable to tax under the Act;
 - (b) Time aspect, i.e., net wealth on the valuation date;
 - (c) Location of assets or place aspect; and
 - (d) Ownership aspect, i.e., who is the owner of the wealth on the relevant valuation date.
- Wealth-tax shall not be levied in respect of the net wealth of the following:
 1. any company registered under Section 25 of the Companies Act, 1956;
 2. any cooperative society;
 3. any social club;
 4. any political party within the meaning of explanation to Section 13A of the Income-tax Act; and
 5. any mutual fund within the meaning of Section 10(23D) of the Income-tax Act.
 6. the Reserve Bank of India incorporated under the Reserve Bank of India Act, 1934

- *Incidence of wealth tax:* The liability to wealth-tax depends upon the citizenship and residential status of an individual and in case of a Hindu undivided family upon its residential status alone.
- *Valuation date :* Wealth-tax is levied on the net-wealth of a person as on a particular date, this date is known as the valuation date. The valuation date for wealth-tax purposes is the last day of the previous year as defined in section 3 of Income Tax Act, 1961.
- *Tax Rate:* Wealth-tax shall be charged in respect of the net wealth on the corresponding valuation date of every individual, Hindu Undivided Family and company at the rate of one per cent of the amount by which the net wealth exceeds thirty lakh rupees.
- *Computation of Net Wealth:* According to Section 2(m) “net-wealth” means the amount by which the aggregate value computed in accordance with the provisions of this Act of all the assets, wherever located, belonging to the assessee on the valuation date, including assets required to be included in his net wealth as on that date under this Act, is in excess of the aggregate value of all the debts owed by the assessee on the valuation date which have been incurred in relation to the said assets.
- *Assets:* As per Section 2(ea) “assets” in relation to the assessment year commencing on the 1st day of April, 1993, or any subsequent assessment year, means:
 - (i) House
 - (ii) Motor Cars (other than those used by the assessee in the business of running them on hire or as stock-in-trade);
 - (iii) Jewellery
 - (iv) Yachts, boats and aircrafts (other than those used by the assessee for commercial purposes);
 - (v) Urban land;
 - (vi) Cash in hand, in excess of fifty thousand rupees, of individuals and Hindu undivided families and in the case of other persons any amount not recorded in the books of account.
- *Assets belonging to others but includable in the net-wealth of an individual (Deemed Assets) Section 4*

Ordinarily, in computing the net wealth of an assessee, only the assets which belong to him on valuation date are taken into account. However, to reduce the liability to wealth-tax, an individual may transfer his assets without adequate consideration to his spouse, son's wife, AOP etc.

 - (1) Assets transferred to spouse [Section 4(1)(a)(i)]
 - (2) Assets transferred to spouse [Section 4(1)(a)(i)]
 - (3) Assets held by minor child [Section 4(1)(a)(ii)]
 - (4) Assets transferred to a person or association of persons [Section 4(1)(a)(iii)]
 - (5) Assets transferred under revocable transfers [Section 4(1)(a)(iv)] Assets transferred by an individual to son's wife or son's minor child including step child and adopted child [Section 4(1)(a)(v)]
 - (6) Assets transferred by an individual for the benefits of son's wife [Section 4(1)(a)(vi)]
 - (7) Interest in the assets of the firm, etc. [Section 4(1)(b)] Converted Property [Section 4(1A)]
 - (8) Transfer by means of entries in the books [Section 4(5A)]
 - (9) Impartible estate [Section 4(6)]
 - (10) House from a co-operative housing society [Section 4(7)]

– Assets Exempt From Wealth-Tax

Under Section 5, wealth-tax shall not be payable by an assessee in respect of the following assets and such assets shall not be included in the net wealth of the assessee.

- (1) Any property held by the assessee under a trust or other legal obligation for any public purpose of a charitable or religious nature in India.
- (2) The interest of the assessee in the coparcenary property of any H.U.F. of which he is a member.
- (3) Any one building in the occupation of a former ruler of a princely state which has been declared by the Central Government as his official residence immediately before the commencement of the Constitution (Twenty Sixth Amendment) Act, 1971.
- (4) Jewellery in the possession of any Ruler (excluding his personal property) which has been recognised before the commencement of the Wealth-tax Act, by the Central Government, as his heirloom
- (5) An assessee being a person of Indian origin or a citizen of India who was ordinarily residing in a foreign country and who, on leaving such country, has returned to India with the intention of permanently residing therein, moneys and the value of assets brought by him into India and the value of the assets acquired by him out of such money.
- (6) One house or part of a house belonging to an individual or a Hindu Undivided Family; or a plot of land comprising an area of five hundred square meters or less.

– *Debt and Liabilities* : The word debt is not defined under the Act. But in the very nature of things, the deductible debt or liability must be “external” to the concerned assessee that is to say in favour of other persons, or parties. In other words, from the “liabilities side” of his Balance Sheet, his own capital, reserves and the profit and loss a/c credit balance etc., must be ignored altogether. In order to compute the net-wealth of the assessee, the aggregate value of the debts and liabilities which are legally enforceable against him on the valuation date must be deducted from the aggregate value of the assets.

– *Location of assets and liabilities*: The determination of location of assets and debts is necessary for the following three reasons:

- (i) The assets and debts located outside India and belonging to non-citizens are not included in the net-wealth.
 - (ii) Payment of tax may be held in abeyance where the assets taken into account for assessment are located outside India in cases where the laws of that country prohibit or restrict the remittance of money to India.
 - (iii) Tax rebate is granted to an individual and a H.U.F. in respect of their assets located outside India.
- *Valuation of assets*: Wealth-tax is charged on the net-wealth of the assessee, therefore, it is an important function of the Assessing Officer to determine the value of the assets held by the assessee on the valuation date.
- *Rounding Off of Wealth Tax*: Under Section 44C, the net-wealth computed under the provisions of the Act shall be rounded off to the nearest multiple of ₹ 100.
- *Filing of Return*: The procedure under the Wealth-tax Act for making the assessment of net wealth begins with the filing of a return of wealth. Section 14 of the Act contains the relevant provisions relating to the filing of return of Wealth.

SELF TEST QUESTIONS

These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation.

MULTIPLE CHOICE QUESTIONS

1. Which one of the following is not an 'asset' under section 2(ea) of the Wealth tax Act, 1957 —
 - (a) Motor car
 - (b) Boat and aircraft
 - (c) Guest house
 - (d) Balance in bank account.
2. Net wealth computed under the Wealth-tax Act, 1957 shall be rounded off to the multiple of _____.
 - (a) ₹10
 - (b) ₹ 100
 - (c) ₹ 1000
 - (d) Not to be rounded off
3. Wealth-tax is charged at the rate of _____ % on net wealth in excess of ₹30 lakh under the Wealth-tax Act, 1957.
 - (a) 10
 - (b) 1
 - (c) 20
 - (d) 30

ELABORATIVE

1. What are the units of assessment under the Wealth-tax Act, 1957?
2. What is the nexus between the taxable wealth and residential status of an assessee as regards tax incidence? Does it make any difference if the assessee is: a resident, non-resident, and, resident but not ordinarily resident? Illustrate.
3. What do you understand by 'deemed assets'? State the assets to which the deeming provisions of the Wealth-tax Act are applicable.
4. (a) Are there any assets exempt from Wealth-tax?
 (b) Are the following assets liable to Wealth-tax?
 - (i) An asset located outside India.
 - (ii) The property held by the assessee under trust or other legal obligation for charitable purposes.
 - (iii) The interest of the assessee in the coparcenary property of the H.U.F.
 - (iv) House Property
 - (v) Agricultural building
 - (vi) Life Insurance Policy
 - (vii) Trees

(viii) Deposits in Post-Office Savings Bank A/c ₹ 30,000

(ix) Equity shares of company

(x) Units of the Unit Trust of India

(xi) Bank balance on the valuation date

(xii) Race horse.

5. What do you understand by "converted property"? How much share of the "converted property" shall be included in the net-wealth of transferor after partition of the H.U.F.? Illustrate.

6. In what circumstances is the value of property transferred to a spouse, of the transferor includable in the transferor's net-wealth?

7. Write short notes on :

(i) Net wealth.

(ii) Valuation date.

(iii) Rounding off of net wealth and the wealth-tax.

(iv) Specified area.

(v) Valuation of jewellery.

8. Describe the steps involved in valuation of house property as per Schedule III of the Wealth-tax Act, 1957.

9. How would you determine the value of the following :

(1) Assets of Business.

(2) Jewellery.

(3) Interest in a firm or an association of persons.

10. State the debts which are not deductible in computing the net wealth of an assessee.

11. (a) Are there any concessions in Wealth-tax ? Briefly state the same.

(b) Why is determining of location of assets and liabilities necessary?

12. Are the following assessable to wealth-tax and, if so, at what status?

(i) Association of persons;

(ii) Public Charitable Trust.

13. Who is liable to pay wealth-tax after the partition of a Hindu Undivided Family?

14. Write short note on Payment and Recovery of Wealth-tax under the Wealth-tax Act.

15. Who can rectify a mistake and at whose request? Mention the time limit for rectification of a mistake.

16. The Assessing Officer discovers that wealth has escaped assessment. What steps are open to him to remedy the defect and what are the time limits for taking such steps?

17. If a person fails, without reasonable cause, to furnish a return of his net wealth, he lays himself open to three types of punishments. What are those?

18. Enumerate the penalties leviable in the following cases :

- (i) Failure to pay tax on the basis of "Self-assessment".
 - (ii) Concealment of assets or furnishing inaccurate particulars of assets or debts.
 - (iii) Failure to pay tax on demand.
 - (iv) Failure to answer questions demanded of him.
19. What are the provisions of the Wealth-tax Act regarding prosecution in the following cases:
- (i) Willful attempt to evade tax.
 - (ii) Failure to furnish return of net wealth.
 - (iii) Abetment of false return, etc.
 - (iv) False statement in verification by a Registered Valuer.
20. Under what circumstances, the Commissioner may revise the orders passed by any authority subordinate to him under Wealth Tax Act, 1957? Can he pass an order prejudicial to the assessee, when he revises the order at the request of the assessee?

PRACTICAL QUESTIONS

1. From the following information, compute the net wealth and tax liability of Lalit for the assessment year 2014-15 who is a citizen and resident and ordinarily resident in India :

	₹
Residential house in Delhi	50,00,000
Residential house situated outside India	25,00,000
Maruti Esteem car for personal use	6,00,000
Personal jewellery in India	10,00,000
Personal jewellery outside India	5,00,000
Bank loan taken to purchase residential house in Delhi	12,50,000
Cash in hand	75,000
Bank balance	2,50,000
Farm house, which is outside 9 kms. of the municipal limits	15,00,000
Urban land on which construction is not allowed	13,00,000
Equity shares of AB Associates	3,50,000
Income-tax liability	50,000

2. Raman has following assets and liabilities as on 31st March, 2014. Compute his net wealth and wealth-tax liability for the assessment year 2014-15 :

	Market Value (₹)
(i) Cash in hand	75,000
(ii) Cash at bank	10,00,000
(iii) Residential house (Loan taken to purchase this house ₹ 5,00,000)	45,00,000
(iv) Land in rural area (it is within 5 kms. from Delhi)	48,00,000

(v)	Land in urban area (construction not permitted under the law, loan taken to purchase this land ₹ 3,00,000)	28,00,000
(vi)	Motor car for personal use	14,00,000
(vii)	Jewellery	6,00,000
(viii)	Aircraft for personal use (Loan taken to purchase aircraft ₹ 20,00,000)	1,00,00,000
(ix)	Farm house situated within 20 kms. from local limits of municipality	24,00,000
(x)	One let-out residential house given on rent throughout the year (Loan taken to construct this house ₹ 2,00,000)	20,00,000

3. Compute the net wealth and tax liability of assessment year 2014-15 of Sona Jewels which is engaged in jewellery business. Following are the particulars of assets on 31st March, 2014 :

	₹
Factory building (W.D.V)	80,00,000
Bank balance	15,00,000
Unaccounted cash	5,20,000
Silver ware	56,00,000
Gold jewellery	54,00,000
Car (W.D.V)	10,00,000
Farm house within municipal limit	25,00,000
Guest house in Britain	90,00,000

The market value of car is ₹ 15 lakh. The assessee has raised a loan of ₹50 lakh from a bank by mortgaging guest house. The loan was utilised to construct factory building.

ANSWERS/HINTS

Multiple choice question

1. (d); 2. (b); 3. (b)

Practical Question

1. ₹ 61,25,000, ₹ 31,250; 2. ₹ 1,64,25000, ₹ 1,34,250; 3. ₹ 1,35,20,000

Test Your Knowledge

1. (a), (b), (c); 2. (a), (c), (d); 3. (b); 4. (a); 5. True; 6. (a); 7. (d)

SUGGESTED READINGS

1. Dr. V.K. Singhania : Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.
2. Girish Ahuja and Ravi Gupta : Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.
3. Dr. V.K. Singhania & Dr. Kapil Singhania : Professional Approach to Direct Taxes Law & Practice; Bharat Law House, New Delhi.
3. Dr. V.K. Singhania & Dr. Kapil Singhania : Direct Taxes Law & Practice; Taxmann Publications Pvt. Ltd., New Delhi.

Lesson 15

Basic Concepts of International Taxation

LESSON OUTLINE

- An overview of International Tax Provisions
 - from Indian perspective
- Tax havens
- Controlled Foreign Corporation (CFC)
- The Sub Part F Regime
- Double Taxation Relief
 - (i) Bilateral and
 - (ii) Unilaterally
- Necessity for DTAA
- International mergers and acquisitions;
- Transfer pricing
 - What is arm's length price?
 - Associated enterprises
 - Meaning of international transaction
 - Transfer pricing – applicability to domestic transactions
 - Transfer pricing – methods
 - Reference to transfer pricing officer
 - Advance pricing agreement
 - Transfer pricing – documentation
 - Transfer pricing – penalty for contravention
- Lesson Round Up
- Self Test Questions

LEARNING OBJECTIVES

After the liberalization of Indian economy and easing of restrictions on the entry of foreign entities, cross border business transactions have increased manifold. With the ratification of WTO by the Government of India, our economy has become robust and an atmosphere has sprung up where FII investments in India have increased tremendously. All these economic activities have ramifications for tax laws of the country. Issues like tax havens, transfer pricing, double taxation, WTO, Subpart F, etc. are required to be taken care of and have become part and parcel of international taxation regime. To overcome difficulties faced by investors from different countries, India in recent years entered into Double Taxation Avoidance Agreements (DTAA) with many countries.

At the end of this lesson, you will

- Understand the basic principles of international taxation.
- Understand the impact of tax law on international transactions.
- Have basic idea of Anti-deferral tax regime scheme world wide
- Able to interpret the Double Tax Avoidance Agreements and able to take the benefit of these agreements where the income is taxed in two countries.
- Understand the impact of transfer pricing on international transactions.

International taxation is a body of legal provisions embedded in the tax laws of each country to cover the tax aspects of cross border transactions.

AN OVERVIEW OF INTERNATIONAL TAX PROVISIONS – FROM INDIAN PERSPECTIVE

After the liberalization of Indian economy and easing of restrictions on the entry of foreign entities, cross border business transactions have increased manifold. With the ratification of WTO by the Government of India, our economy has become robust and an atmosphere has sprang up where FII investments in India have increased tremendously. All these economic activities has ramifications for tax laws of the country. Issues like tax havens, transfer pricing, double taxation, WTO, Subpart F, etc. are required to be taken care of and have become part and parcel of international taxation regime.

With the acceptance of the WTO regime India has embarked on the policy of market reforms and merging with the international business community by providing market access to the overseas investor with nil or qualitatively less restrictions.

In the context of international taxations, including cross border-investments, eliminated double taxation become an important consideration in doing business in India and abroad specially with the double taxation aspect became omnipresent in relations to transactions involving cross border investments with those foreign entities belonging to those countries with which India doesn't have double taxation avoidance agreements.

To overcome difficulties faced by investors from different countries, India in recent years entered into Double Taxation Avoidance Agreements (DTAA) with many countries. Our domestic statute namely, Income Tax Act, 1961 in the year 2001, introduced in the Income Tax Act, 1961 (Act hereinafter) elaborate legislation in Chapter X concerning transferring pricing to be discussed later issues. Section 91 of the Income Tax Act deals with unilateral relief given to the concerned persons of the countries with whom India does not have DTAA. DTAA under section 90 of the Act deals with general aspect concerning bilateral relief, multinational treaties and non-tax treaties.

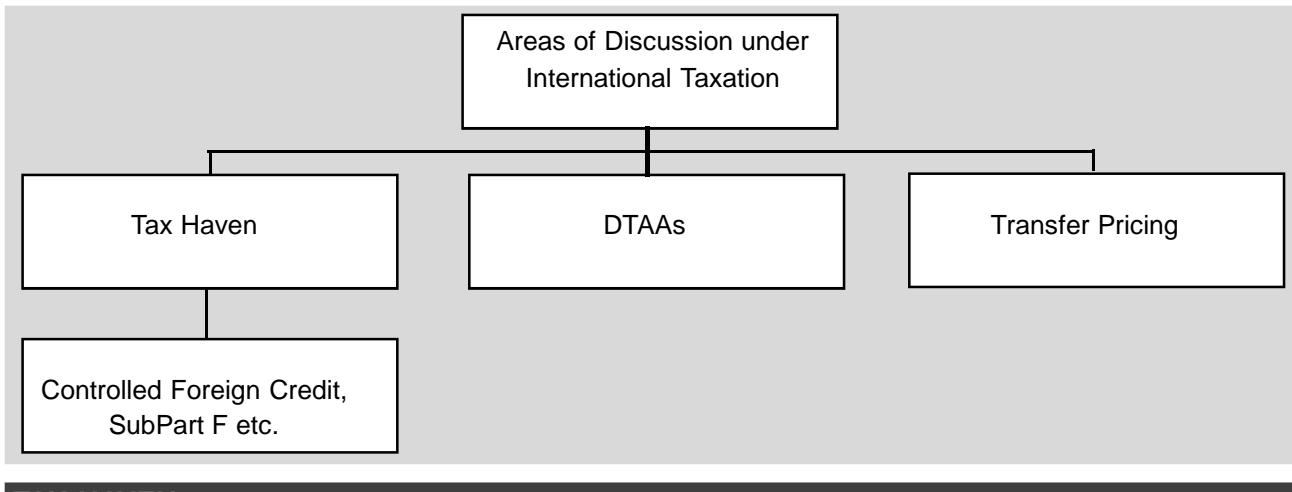
Another way of resolving disputes relating to taxes involving international transactions is through Mutual Agreement Procedure (MAP) in regard to those categories of disputes where there are no DTAA through OECD models and UN models regarding double tax avoidance agreements (the details of which are explained later). In order to reduce the misuse of tax havens, some countries have started the concept of CFC (controlled foreign corporations) to deal with the problems of tax evasion. There are nil tax haven destinations as well as low tax haven destinations.

The Income Tax Act, 1961 contains provisions to take care of transactions having extra-jurisdictional ramifications. Such as some incomes earned abroad by resident tax payers or income earned in India by NRI's and foreigners which generally are taxable in India under certain conditions. In the former case, incomes are taxed as per 'worldwide income' principle, whereas in the latter case it is done through 'source principle'.

OECD-MC [Organization for Economic Co-operation and Development–Model Convention] defines double taxation as, "the imposition of comparable taxes in two (or more) states on the same tax payer in respect of the same subject matter and for identical periods".

In cases of double taxation the parties can get relief either through unilateral measures or bilateral measures or under adjudication by judiciary or through commercial arbitration.

Section 90 of the Income Tax Act, 1961 deals with agreements entered by Government of India with Government of other countries. Section 91 deals with provisions relating to those issues for which India does not have any formal agreements with Government of other countries, regarding avoidance of double taxation. Section 90A releases to granting of permissions to 'specified association' through Official Gazette notification to enter into agreement with foreign governments in regard to giving of relief for double taxation.



TAX HAVEN

A Tax Haven is a place where there is no tax on income or it is taxed at low rate. Individuals or corporate entities move from jurisdiction of high rates of taxes to the region of low tax in order to lower their overall tax liability. This has created competition amongst various governments of the world to lure more investments from abroad. Specially small countries are taking this opportunity to attract more investments from abroad. Many states have adopted different tax structures for different customers. It is like making 'tax haven shopping' available to large multinationals. This policy of the transnational corporate adversely affects the tax base of the country from where such entities transfer their business. It is a process adopted generally by large to medium sized multinationals to outmaneuver to pay lower taxes than those that would have been normally payable. Some critics call it as a method of tax avoidance. The modern concept of tax haven was started about 20 years ago by changing the focus from legislation to corporate vehicles which became pioneers in this field and are usually charged under local taxation (although they usually do not trade locally).

These vehicles are usually called 'exempt companies' or 'International Business Corporations'. But in last ten years due to pressure from OECD, the tax haven countries have adjusted their domestic laws partially to check tax avoidance tax evasion practices.

Determining Factors of Tax Haven

The factors to be considered in taking decision whether a country is tax haven or not are:

1. Nil or Nominal tax Rate: There is no or nominal tax on income (generally or in specified circumstances).
2. No Exchange of Information: There is no system of exchange of information with respect to the tax regime in the tax haven country.
3. Lack of Transparency: The regime lacks transparency
4. Limited Regulatory supervision: No proper regulatory supervision and lack of financial disclosures to the government would also categories a country as Tax Haven.
5. The Government of the country facilitates the establishment of the foreign owned enterprises without the need for strict compliance of local laws or prohibits such entities from having any mechanical impact on the local economy.

The OECD has outlined three parameters to consider whether a jurisdiction is tax haven or not.

- (a) *Rate of tax applicable*
- (b) *Withholding personal financial information.*
- (c) *Lack of transparency.*

Doing business through tax haven countries may not always be profitable. Some tax havens have become failure adventures or misadventures, like Beirut, Tangiers, Liberia, etc.

Methodology

The modus operandi followed in doing business through tax havens broadly, are as under :

- (a) *Personal Residency*: Where wealthy individuals reallocate themselves from high tax zones to low tax zones.
- (b) *Asset Holding*: It involves utilizing a trust or a company or a trust owing a company. Usually in this case, an entity from high tax jurisdiction transfers its assets to a trust in a low tax jurisdiction and settles his share in the trust on himself and later to his descendants without going through the vagaries of probate or inheritance tax.
- (c) *Business Activity*: Many corporate entities do not require locational or factor leverage to establish their business entities. Simply by transferring activities to low tax jurisdiction, they can earn 'margin' even though they are not performing any financial activity. They change their tax jurisdictions and through 'rein voicing' process they earn profit via investment in high tax jurisdictions. Example: Reinsurance companies.
- (d) *Financial Intermediaries* : Majority of business activities done in tax havens is through professional financial services such as mutual funds, banking, life insurance 'and pensions. Generally, the funds are deposited with the intermediary in the low tax jurisdiction and intermediary then on-lends or invests the money. Such systems do not normally avoid tax in the principle's customer jurisdiction; it enables financial service providers to provide multi-jurisdictional products without adding an additional layer of taxation. This has proved particularly useful in area of offshore funds.

Worldwide income of the Indian Resident's is taxable in India though section 91 of the Act provides relief by way of credit in respect of the tax paid on their foreign income if, the source is in the country with which there is no DTAA. Non-residents however are subject to source based taxation.

Some important destinations of tax havens are :

In USA – Delaware, Nevada, Wyoming, etc.

In Europe – Andorra, Canary, Lands, The Netherlands, Cyprus etc.

In Asia - Mauritius, Singapore, Dubai, etc.

In Africa : Capetown, Nairobi, etc.

Action taken to avoid harmful tax practices

OECD in May 1998 issued a report on Harmful Tax Competition and has made nineteen specific recommendations. Some of these are:

1. Adopt Controlled Foreign Corporation (CFC) or equivalent rules.
2. Consider Foreign Information Reporting rules.
3. Enter into Tax Information Exchange Agreement (TIEA).
4. Apply the provisions of withholding tax when payments are made to offshore recipients.
5. Curbing treaty shopping term nation of existing treaties with tax havens like Mauritius.
6. Mutual assistance of tax authorities in the recovery of cross border tax claims etc.
7. More international co-operation by establishing forums to avoid harmful tax practice etc.

CONTROLLED FOREIGN CORPORATION (CFC)

The OECD recommended for adoption of CFCs Rules for taxing those entities which defer the tax liability after moving to the tax haven country. A CFC is a legal entity that exists in one jurisdiction but is owned or controlled primarily by taxpayers of a different jurisdiction. The CFC rules may also be termed as 'anti-deferral rules'.

Income from a foreign source is taxed usually after it is accrued or received as income in the country of residence of the taxpayer. The use of intermediary entities in a tax-free or low-tax jurisdiction enables a tax resident to defer (or avoid) the domestic tax on the income until it is repatriated to the residence state.

This tax deferral could lead to an unjustifiable loss to the domestic tax revenue. As countries increasingly ease their exchange control rules, some have enacted Controlled Foreign Corporation rules to prevent the use of low-tax jurisdictions by their tax residents to defer the taxability of foreign income. Under the CFC rules, the domestic law effectively extends the residence rules to tax the income. It requires that the tax on profits, whether distributed or not, be paid by resident tax-payers. Normally, the CFC rules apply only to foreign companies controlled by residents, but certain countries extend it to foreign permanent establishments and trusts.

Many years ago, in the US, the incomes of foreign corporations were not taxed unless it was derived from US sources. In 1962, new tax laws were enacted to deter the use of foreign corporations as a way to avoid taxes. These rules have evolved into the complex rules referred to as the "controlled foreign corporation" rules.

CFCs are a legal consortium of the tax authorities around the world. If income is taxed at some point of time, then the taxpayer will have a greater after-tax retention of income if tax is paid during a future year as opposed to being paid in the present year. An anti-deferral tax regime could compel the foreign company to repatriate the profits, thus resulting in a favorable impact on the foreign exchange inflows as well as shoring up the domestic tax base.

The U.S, the UK, Germany and 25 other countries have adopted CFC regulations. Generally, the CFC regime is enacted by states in which tax liability is imposed on the worldwide income of resident taxpayers. Two operative factors are key to worldwide tax liability and to the generation of tax revenues on foreign source income, that is, the nexus between the state and the taxpayer; and the nexus between the taxpayer and the foreign income, the latter being more important vis-à-vis CFC.

Indian corporate not only scaled up the size of their overseas acquisitions but in several instances bought out companies much larger than them. The time now seems to be right to re-look the Controlled Foreign Corporation (CFC) recommendations of the Kelkar Working Committee Report on Tax Reforms in India.

SUB PART F

Sub Part F means special category of foreign source unearned income that is currently taxed by the Internal Revenue Code, 1986 of US whether or not it is remitted to the U.S. It is basically U.S. financial term used for the U.S. based institutions.

According to definition given under section 952 of the US Code by Legal Information Institute (Cornell University Law School), Sub Part F in "General" means in case of any foreign corporation, sum of :

- (1) insurance income (as defined under section 953),
- (2) the foreign base company income (as determined under section 954),
- (3) an amount equal to the product of–
 - (A) the income of such corporation other than income which–
 - (i) is attributable to earnings and profits of the foreign corporation included in the gross income of a United States person under section 951 (other than by reason of this paragraph), multiplied by

- (B) the international boycott factor (as determined under section 999),
- (4) the sum of the amounts of any illegal bribes, kickbacks, or other payments (within the meaning of section 162 (c)) paid by or on behalf of the corporation during the taxable year of the corporation directly or indirectly to an official, employee, or agent in fact of a government, and
- (5) the income of such corporation derived from any foreign country during any period during which section 901 (j) applies to such foreign country.

The payments referred to in paragraph (4) are payments which would be unlawful under the Foreign Corrupt Practices Act of 1977 if the payor were a United States person. For purposes of paragraph (5), the income described therein shall be reduced, under regulations prescribed by the Secretary, so as to take into account deductions (including taxes) properly allocable to such income.

Sub Part F was enacted in U.S., in 1962, through it has been amended many times but it retained its basic structure.

Sub Part F applies to certain income of "Controlled Foreign Corporations (CFC's)". CFC is a foreign corporation more than 50% of which by vote or value is owned by U.S. persons including U.S. citizens owing a 10% or greater interest in the corporation by VOTE (U.S. Shareholders). 'U.S. persons' includes U.S. citizens, residents, corporations, partnerships, trusts and estates. If a CFC has Sub Part F income, each U.S. shareholder must currently include prorates share of that income in its gross income as a deemed dividend.

Sub Part F rates attempt to prevent (or negate the tax advantage from) deflection of income, either from the United States or from the foreign country in which earned, into another jurisdiction which is a tax haven or which has a preferential tax regime for certain types of income. Thus, Sub Part F generally targets passive income and income that is split off from the activities that produced the value in the goods or services generating the income. Conversely Sub Part F does not require current taxation of active business income except when the income of a type that is easily reflected to tax haven, such as shipping income except when the income type earned in certain transaction of related parties. In related party transactions, deflections of is much easier because a unified group of corporations can direct the flow of income between entities in different jurisdictions.

A major category of Sub Part F income is Foreign Personal Holding Company Income (FPACI). This category includes interest, dividend, events and royalties. It also includes gains from the sale of property that produces passive income or that it is held for investment, gains from commodity transaction and gains from foreign company transactions as well as certain other income that is, in effect, the equivalent of interest or dividends. Because of its passive nature, such income often is highly mobile and can be easily deflected.

Income from the sale of the goods manufactured by the selling CFC is excluded from the FBCSI Rules. This exception is provided because, when the CFC performs the manufacturing generally, sales function has not been separated from manufacturing function. However, because branches established in a separate jurisdiction can facilitate the deflection of income, the FBCSI provision contain a branch rule that treats income from the sale of goods manufactured by the CFC as FBCSI in certain cases when the selling and manufacturing, operation have been separated into different tax jurisdictions to obtain a lower rate of tax for the sale income.

Foreign base company services income is another category of Sub Part F income that applies to active income that can be deflected to a low tax jurisdictions through related party transactions, in this case, through the performance of Services FBCSI includes income from services performed outside the CFC's country of incorporation for or on behalf of related person. These rules are generally to address circulation in which service activities are separated from other business activities of a compensation into a separate subsidiary located in another jurisdiction to obtain a lower rate of tax for the services income.

This result can occur not only when the CFC perform the services for an unrelated person. Thus, the regulations contain 'a substantial assistance' rate under which if a related person provides the CFC with substantial assistance contributing to the performance of the services will be treated as performed for on behalf of a related person.

Source: The aforesaid is the extracts from, "The Deferral of Income Earned through U.S. Controlled Foreign Cooperatives. A policy study, upto pg xiv Office of Tax Policy Department of Treasury U.S. Government December 2000."

MEANING OF THE TERM 'RESIDENT OF CONTRACTING STATE'

Residence as defined in double taxation treaties is different from residence as defined for domestic tax purposes. Tax treaties generally follow the OECD Model Convention which provides:

For the purposes of this Convention, the term 'Resident of a Contracting State' means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, (UNMC also; place of incorporation), place of management or any other criterion of a similar nature, and also includes that State and any political sub-division or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or Capital situated therein.

Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows:

- (a) he shall be deemed to be a resident only of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (centre of vital interests);
- (b) if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has an habitual abode;
- (c) if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national;
- (d) if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated.

DOUBLE TAXATION RELIEF

The situation of double taxation will arise where the income gets taxed in two or more than two countries whether due to residency or source principle as the case may be. The problem of double taxation arises if the income of a person is taxed in one country on the basis of residence and on the basis of residency in another country or on the basis of both. To mitigate the double taxation of income the provisions of double taxation relief were made. The double taxation relief is available in two ways one is unilateral relief and other is bilateral relief.

Government of India can enter into agreement with a foreign government vide Entry 14 of the Union List regarding any matter provided Parliament verifies it. Double Tax Avoidance Agreement is a kind of bilateral treaty or agreement, between Government of India and any other foreign country or specified territory outside India. Such treaty or agreement is permissible in terms of Article 253 of the Constitution of India.

(a) Section 90: Agreements with Foreign Countries or specified territories

India has entered into bilateral agreements with many countries regarding avoidance of double taxation including tax avoidance and tax evasion issues.

Section 90 of the Income Tax Act 1961 deals with relief granted to assesses involved in paying taxes twice that is, paying taxes in India as well as in Foreign Countries or specified territory outside India.

As per section 90, the Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India:

- (a) for granting relief in respect of
 - (i) income on which tax have been paid both under Income Tax Act, 1961 and Income-Tax Act prevailed in that country or specified territory or
 - (ii) income-tax chargeable under Income Tax Act, 1961 and under the corresponding law in force in that country or specified territory to promote mutual economic relations, trade and investment, or
- (b) for the avoidance of double taxation of income under Income Tax Act, 1961 and under the corresponding law in force in that country or specified territory.
- (c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under Income Tax Act, 1961 or under the corresponding law in force in that country or specified territory, or investigation of cases of such evasion or avoidance, or
- (d) for recovery of income-tax under Income Tax Act, 1961 and under the corresponding law in force in that country or specified territory

Where the Central Government has entered into an agreement with the Government of any country outside India or specified territory outside India for granting relief of tax, avoidance of double taxation, then, the provisions of Income Tax Act, 1961 shall apply to the assessee to whom such agreement applies, to the extent they are more beneficial to him. The assessee shall have a certificate of his being a resident.

All relief's announced by the Union Government are through Official Gazette. It has been stated in the provision that charge of tax in respect of a foreign company at a higher rate than the rate at which a domestic company is chargeable shall not be regarded as less favourable charge or levy of tax in respect of such foreign company.

The benefit of double taxation agreement or tax treaty shall be applicable only when a tax residency certificate is obtained of his residence in any country outside India or specified territory outside India from the Government of that country or specified territory.

(b) Section 90A

The Central Government is empowered by section 90A to enter into an agreement with any specified association in the specified territory outside India and the Central Government has been authorized to make such provisions as may be necessary for adopting and implementing such agreement. The provisions may be made:

- (a) for granting relief in respect of
 - (i) income on which tax have been paid both under Income Tax Act, 1961 and Income-Tax Act prevailed in that specified territory or
 - (ii) income-tax chargeable under Income Tax Act, 1961 and under the corresponding law in force in that specified territory to promote mutual economic relations, trade and investment, or
- (b) for the avoidance of double taxation of income under Income Tax Act, 1961 and under the corresponding law in force in that specified territory.
- (c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under Income Tax Act, 1961 or under the corresponding law in force in that specified territory, or investigation of cases of such evasion or avoidance, or
- (d) for recovery of income-tax under Income Tax Act, 1961 and under the corresponding law in force in that specified territory

Where the Central Government has entered into an agreement with the specified association of any specified territory outside India for granting relief of tax, avoidance of double taxation, then, the provisions of Income Tax Act, 1961 shall apply to the assessee to whom such agreement applies, to the extent they are more beneficial to him.

Note : The assessee shall also provide such other document & information as may be prescribed.

“Specified Association” for this section means any institution, association or body whether incorporated or not, functioning under any law for the time being in force India or the laws of specified territory outside India and which may be notified as such by the Central Government.

“Specified Territory” means any area outside India which may be notified as such by the Central Government for the purpose section 90A. The provision under this section will apply to the assessee to the extent these are beneficial to them. This section provides relief in respect of double taxation in respect to countries with which India has no DTAA.

(c) Section 91

In any previous year, a person resident in India, has paid tax in any country with which India has no bilateral agreement under Section 90 for the relief or avoidance of double taxation in respect of his income which accrued or arose during that previous year under the law in force in that country, by deduction or otherwise, he shall be entitled to the deduction from the Indian Income Tax payable by him calculated on such doubly taxed income at this Indian Rate of Tax or the rate of the said country which ever is lower or at Indian rate of tax, if both rates are equal.

In case of any person resident in India, earns income from agricultural operation in Pakistan and paid tax thereof can seek relief at rate being lower of the following alternatives namely :

- (i) Tax actually paid in Pakistan
- (ii) Amount computed under Indian Tax Rates.

If any non-resident person is assessed on his share in the income of a registered firm assessed as resident person in India in any previous year and such share includes any income accruing or arising outside India during that previous year (and which is not deemed to accrue or arise in India) in a country with which there is no agreement under Section 90 for the relief or avoidance of double taxation and he proves that he has paid income tax by deduction or otherwise under the law in force in that country in respect of the income so included he shall be entitled:

- to a deduction from the Indian income tax payable by him of a sum calculated on such doubly taxed income so included
- at the Average Indian Income Tax Rate or
- the Average Foreign Tax Rate ,

Whichever is lower or at the Indian rate of tax if both the rates are equal.

Indian Tax on doubly taxed income:

$$\frac{\text{Tax on Total Income In India} \times \text{Doubly Taxed Income}}{\text{Total Income in India}}$$

Foreign Tax on doubly taxed income

$$\frac{\text{Tax Paid In Foreign Country} \times \text{Doubly Taxed Income}}{\text{Total Income in Foreign Country}}$$

Example:

Mr. Anuj an individual, resident of India in the previous year receives Professional fees of ₹ 1,70,000 on 7th August 2013 and ₹ 2,55,000 on 15th March 2014 for rendering services in Pakistan on which TDS of ₹ 30,000 and ₹ 45,000 have been deducted respectively. He incurred ₹ 1,60,000 as expenditure for earning this fees. He paid ₹ 90,000 towards PPF. His Income from other sources is ₹ 2,60,000. Compute Tax liability & relief under section 91.

Solution:

**Computation of Relief under section 91 of Mr. Anuj
For the Assessment Year 2014-15**

1. Computation of tax liability of Mr. Anuj as per the Income Tax Act, 1961

	₹	₹
Income under the head business & profession:	5,00,000	
Less: Expenditure incurred	<u>1,60,000</u>	3,40,000
Income from other sources		<u>2,60,000</u>
Gross Total income		6,00,000
Less: Deduction u/s 80C: PPF		<u>90,000</u>
Total Income		<u>5,10,000</u>
Tax on ₹ 5,10,000		32,960
Less: Relief u/s 91		<u>21,973</u>
Tax Payable (rounded off)		<u>10,987</u>

2. Computation of relief u/s 91

Doubly Taxed Income = ₹ 3,40,000

Total Income in India = ₹ 5,10,000

Tax on total income in India = ₹ 32,960

Tax paid in foreign country = ₹ 75,000

Total income assessed in foreign country = ₹ 5,00,000

(a) Tax on such doubly taxed income in India:

$$\frac{32,960 \times 3,40,000}{5,10,000} = \text{₹ } 21,973$$

(b) Tax on such doubly taxed income in foreign country:

$$\frac{75,000 \times 3,40,000}{5,00,000} = \text{₹ } 51,000$$

Relief u/s 91 will be lower of (a) or (b) above i.e. ₹ 21,973/-

NECESSITY FOR DTAA

The need for Double Taxation Avoidance Agreement (DTAA) arises because of rules in two different countries regarding chargeability of income based on receipt and accrual, residential status etc. Double taxation is frequently avoided through DTAAAs entered into by two countries for the avoidance of double taxation on the same income. The DTAA eliminates or mitigates the incidence of double taxation by sharing revenues arising out of international transactions by the two contracting states to the agreement. As there is no clear definition of income and taxability thereof, which is accepted internationally, an income may become liable to tax in two countries. In such a case, the possibilities are as under:

1. The income is taxed only in one country.
2. The income is exempt in both countries.

3. The income is taxed in both countries, but credit for tax paid in one country is given against tax payable in the other country.

If the two countries do not have DTAA then in such a case, the domestic law of the country will apply. In the case of India, the provisions of Section 91 of the Income-Tax Act will apply. The Central Board of Direct Taxes has clarified vide Circular No.333 dated 2nd April, 1982 that in case of a conflict in the provisions of the agreement for Tax Avoidance of double taxation and the Income Tax Act, the provisions contained in the Agreement for Double Tax Avoidance will prevail.

“Economic Liberalization in India” as earlier started from 1991 has covered a wide area touching upon the different fields of international trade, exchange control, monetary and industrial policies, trade and fiscal policies, economic and cultural relations aimed at accelerating the growth in all spheres with a view to bringing about globalization of the India economy. The liberal and broad based economic and commercial relationship between India and various foreign countries in recent years had led to more collaboration and joint ventures at various levels in the public and private sectors to keep pace with the ever changing international advancement in trade, commerce, science and technology. The inflow of multinationals to setup business ventures in India coupled with the funds from Non-residents coming for short-term and long-term investments in India have helped to achieve a sound and stable economy and India today stands recognized internationally. The political situations due to changes in the Governments at the central and state levels have not adversely affected the growth of international trade and commerce between India and other countries.

The Government of India has entered into numerous tax treaties as well as trade agreements with various foreign countries to provide stability and certainty to the tax laws and commercial relationship between the parties in India and abroad. The large number of judicial pronouncements including advance rulings in the recent years under the tax laws, both direct and indirect, have added to the confidence of Non-residents being inspired with the Indian fiscal and judicial systems. The wealth of judicial decisions from the Supreme Court as well as the High Courts and the tribunals in deciding numerous tax disputes help to remove the uncertainties and ambiguities in the tax system and administration. The tax treaties have helped both the collaborators from abroad and the Indian enterprises in the private and public sectors to know precisely the nature, extent and scope of the tax liability as also the country in which tax is payable.

Taxation of Income from Air and Shipping Transport under DTAA

The DTAA is based on four basic models of DTAA and they are – OECD Model Tax Convention (emphasis is on residence principle), UN Model (combination of residence and source principle but the emphasis is on source principle), US Model (it's the Model to be followed for entering into DTAAAs with the U.S. and its peculiar to the US) and the Andean Model (model adopted by member States namely Bolivia, Chile, Ecuador, Columbia, Peru and Venezuela).

Income derived from the operation of Air transport in international traffic by an enterprise of one contracting state will not be taxed in the other contracting state. In respect of an enterprise of one contracting state, income earned in the other contracting state from the operation of ships in international traffic, will be taxed in that contracting state wherein the place of effective management of enterprise is situated. However some DTA agreements contain provisions to tax the income in the other contracting state also, although at reduced rate.

These agreements follow a near uniform pattern in as much as India has guided itself by the UN model of double taxation avoidance agreements. The agreements allocate jurisdiction between the source and residence country. Wherever such jurisdiction is given to both the countries, the agreements prescribe maximum rate of taxation in the source country which is generally lower than the rate of tax under the domestic laws of that country. The double taxation in such cases are avoided by the residence country agreeing to give credit for tax paid in the source country thereby reducing tax payable in the residence country by the amount of tax paid in the source country. These agreements give the right of taxation in respect of the income of the nature of interest, dividend, royalty and fees for technical services to the country of residence. However the source country is also given the

right but such taxation in the source country has to be limited to the rates prescribed in the agreement. The rate of taxation is on gross receipts without deduction of expenses.

The Concept of Permanent Establishment (PE)

One of the important terms that occur in all the Double Taxation Avoidance Agreements is the term 'Permanent Establishment' (PE) which has not been defined in the Income Tax Act. However as per the Double Taxation Avoidance Agreements, PE includes, a wide variety of arrangements i.e. a place of management, a branch, an office, a factory, a workshop or a warehouse, a mine, a quarry, an oilfield etc. Imposition of tax on a foreign enterprise is done only if it has a PE in the contracting state. Tax is computed by treating the PE as a distinct and independent enterprise.

Some Salient aspects concerning a PE could be discussed as under :

- PE is defined with reference to place and persons;
- PE could be a fixed place, a construction site, service PE, agency PE branch etc.
- PE denotes non-resident's business preserves. The degree of preserve which could constitute PE has been illustrated by 'inclusions and exclusions'.
- An enterprise is liable to tax on its profits in a foreign country, if it conducts its subsidiary in that country through PE.

Isolated or occasional transactions through some persons or agency do not create liability for tax is the basis of PE. There has to be continuity of activities contributing to the earning of income—something more than mere transaction of purchase and sale or transactions of preparatory or auxiliary nature. Such activities must be value creating activities requiring capital and lesson. 'Permanent' in PE does not mean everlasting.

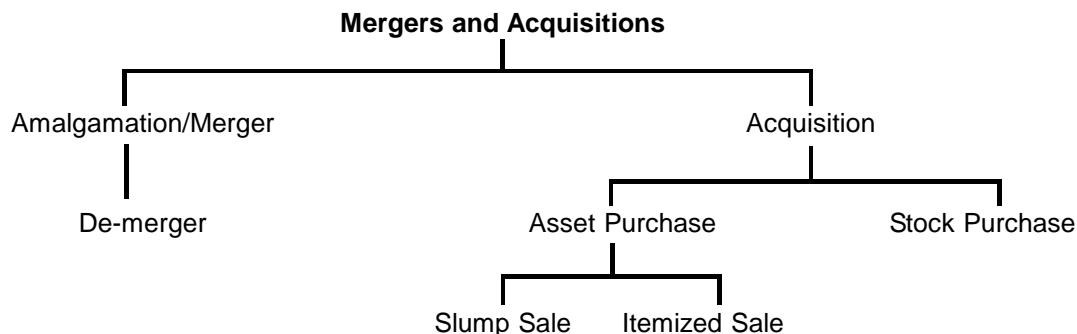
In order to avoid double taxation it is provided that if a resident of India becomes liable to pay tax either directly or by deduction in the other country in respect of income from any source, he shall be allowed credit against the Indian tax payable in respect of such income in an amount not exceeding the tax borne by him in the other country on that portion of the income which is taxed in the said other country. The same benefit is available to the resident of the other Country, on income taxed in India.

TAXATION ASPECT OF INTERNATIONAL MERGER AND ACQUISITIONS

The law relating to transfer pricing in India is still in its infancy. Some decisions recently from the Tribunal and High Court have clarified some issues. However, by its very nature the law to procedures on the subject are sound to be long drawn and complicated. It will take time before the concepts get cleared and stabilized.

With the Globalised economy, trans-border merger and acquisitions are now common phenomena specially in advanced and developing companies. India is catching up with the world trend with respect to transactions involving Mergers and Acquisitions and cross border acquisitions and mergers are getting popular.

In India Mergers and Acquisitions take place in the following ways:



Definition of 'Amalgamation' under the Income Tax Act, 1961

Section 2(1B). It is defined thus : "Amalgamation" in relation to companies means, the merger of one or more companies with another company or the merger of two or more companies to form one company"

Provided:

- All assets to be transferred from amalgamating company to the amalgamated company.
- All liabilities including contingent liabilities to be transferred from amalgamating company to amalgamated company.
- Shareholders holding at least 3/4th in value of shares of the amalgamating company should become shareholders of the amalgamated company.

ACQUISITION

No definition of 'Acquisition' has been given of the term in the Income Tax Act. However, as per Section 2(1B) of the Income Tax Act amalgamation is not include acquisition. The relevant portion in section 2(1B) reads thus :

"Amalgamation", in relation to companies, means the merger of one or more companies with another company or the merger of two or more companies to form one company (the company or companies which so merge being referred to as the amalgamating company or companies and the company with which they merge or which is formed as a result of the merger, as the amalgamated company) in such a manner that–

- (i) All the property of the amalgamating company or companies immediately before the amalgamation becomes the property of the amalgamated company by virtue of the amalgamation;
- (ii) All the liabilities of the amalgamating company or companies immediately before the amalgamation become the liabilities of the amalgamated company by virtue of the amalgamation;
- (iii) Shareholders holding not less than [three-fourths] in value of the shares in the amalgamating company or companies (other than shares already held therein immediately before the amalgamation by; or by a nominee for, the amalgamated company or its subsidiary) become shareholders of the amalgamated company by virtue of the amalgamation.

Otherwise than as a result of the acquisition of the property of one company by another company pursuant to the purchase of such property by the other company or as a result of the distribution of such property to the other company after the winding up of the first mentioned company.

Benefits for amalgamation under the Income Tax Act, 1961

Amalgamations have been given certain benefits under the Income Tax Act. These are :

- (i) No tax is to be charged on capital gain arising on :

Scheme of Amalgamation

- (i) **Section 47(vi)** : Any transfer, in a scheme of amalgamation, of a capital asset by the amalgamating company to the amalgamated company is an Indian Company provided that amalgamated company is an Indian Company.

Transfer of Capital Asset – From Amalgamating Company – To Indian Amalgamated Company.

- (ii) **Section 47(via)** : Any transfer, in a scheme of amalgamation, of a capital asset being a share or shares held in an Indian company, by the amalgamating foreign company to the amalgamated foreign company, if –

- (a) At least twenty-five per cent of the shareholders of the amalgamating foreign company continue to remain shareholders of the amalgamated foreign company; and

- (b) Such transfer does not attract tax on capital gains in the country, in which the amalgamating company is incorporated;
- (iii) **Section 47(vii):** Any transfer by a shareholder, in a scheme of amalgamation, of a capital asset being a share or shares held by him in the amalgamating company if-
 - (a) The transfer is made in consideration of the allotment to him of any share or shares in the amalgamated company; and
 - (b) The amalgamated company is an Indian company.

Transfer of Capital Assets from a shareholders for consideration of allotment to him of any share(s) in the Indian amalgamated company.

- (iv) **Section 79:** Carry forward and set-off losses in case of certain companies : Notwithstanding anything contained in this Chapter, where a change in shareholding has taken place in a previous year in the case of a company, not being a company in which the public are substantially interested, no loss incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year unless–

- (a) On the last day of the previous year the shares of the company carrying not less than fifty-one per cent of the voting power were beneficially held by persons who beneficially held by persons who beneficially held shares of the company carrying not less than fifty-one per cent of the voting power on the last day of the year or years in which the loss was incurred.

Provided that nothing contained in this section shall apply to a case where a change in the said voting power takes place in a previous year consequent upon the death of a shareholder or on account of transfer of shares by way of gift to any relative of the shareholder making such gift

Provided further that nothing contained in this sections shall apply to any change in the shareholding of an Indian company which is a subsidiary of a foreign company as a result of amalgamation or demerger of a foreign company subject to the condition that fifty-one per cent shareholders of the amalgamating or degermed foreign company continue to be the shareholders of the amalgamated or the resulting foreign company.

- (v) **Section 72A(2) :** Provisions relating to carry forward and set-off accumulated loss and unabsorbed depreciation allowance in amalgamation or demerger, etc.

Notwithstanding anything contained in sub-section (1), the accumulated loss shall not be set off or carried forward and the unabsorbed depreciation shall not be allowed in the assessment of the amalgamated company unless –

- (a) The amalgamating company –
 - (i) has been engaged in the business, in which the accumulated loss occurred or depreciation remains unabsorbed, for three or more years;
 - (ii) has held continuously as on the date of the amalgamation at least three-fourths of the book value of fixed assets held by it two years prior to the date of amalgamation.
- (b) The amalgamated company –
 - (i) holds continuously for a minimum period of five years from the date of amalgamation at least three-fourths of the book value of fixed assts of the amalgamating company acquired in a scheme of amalgamation.
 - (ii) continues the business of the amalgamating company for a minimum period of five years from the date of amalgamation;

- (iii) fulfills such other conditions as may be prescribed to ensure the revival of the business of the amalgamating company or to ensure that the amalgamation is for genuine business purpose.
- (iv) No tax exemption is provided under the Income Tax Act, 1961, in case of amalgamation of an Indian Company into a foreign company wherein the resultant amalgamated company is a foreign company.
- (v) In U.S.A., Section 367 of their Internal Revenue Code (IRC) exempts U.S. corporate entity in some cases relating to taxation aspect relating to merger and acquisitions.
- (vi) In E.U., Deferral of Tax on Capital Gains on the Capital Assets transferred and shares received in consideration in qualifying transaction. But such relief can be claimed only when the assets become connected with local Permanent Establishment of the Amalgamating Company. Apart from this, domestic law will be effective in connection with carry forward of losses. But after formation of CFC requires and formulation of Bilateral Treaties, the incidence of tax evasion and tax-avoidance has been minimal.

TRANSFER PRICING

In the present age of globalization, diversification and expansion, most of the companies are working under the umbrella of group engaged in diversified fields/sectors leading to large number of transactions between related parties.

Related Party transaction means the transaction between/among the parties which are associated by reason of common control, common ownership or other common interest.

The mechanism for accounting, the pricing for these related transactions is called Transfer Pricing.

Transfer Price refers to the price of goods/services which is used in accounting for transfer of goods or services from one responsibility centre to another or from one company to another associated company. Transfer price affect the revenue of transferring division and the cost of receiving division. As a result, the profitability, return on investment and managerial performance evaluation of both divisions are also affected.

This may be understood well by the following example

1. Arihant & Companies is a group of Companies engaged in diversified business. One of its units i.e. Unit X is engaged in manufacturing of automotive batteries. Another Unit Y is engaged in manufacturing of Industrial Trucks. Unit X is supplying automotive batteries to Unit Y. In such cases transfer price mechanism is used to account for the transfer of automotive batteries.
2. XYZ Co. is expert in providing electrical and electronic services. It is engaged in providing support to its associated company as well as it is engaged in outsourcing contract. If XYZ Co. provides some services to its associated company, the transaction should be accounted at price calculated using transfer price mechanism.

IMPORTANCE OF TRANSFER PRICING

Transfer pricing mechanism is very important for following reasons:

1. Helpful in correct pricing of Product/Services - An effective transfer pricing mechanism helps an organization in correctly pricing its product and services. Since in any organization, transaction between associated parties occurs frequently, it is necessary to value all transaction correctly so that the final product/ services may be priced correctly.
2. Helpful in Performance Evaluation : For the performance evaluation of any entity, it is necessary that all

economic transactions are accounted. Calculation of correct transfer price is necessary for accounting of inter related transaction between two Associated enterprises.

- Helpful in complying Statutory Legislations : Since related party transaction have a direct bearing on the profitability or cost of a company, the effective transfer pricing mechanism is very necessary. For example, if the related party transactions are measured at less value, one unit may incur loss and other unit may earn undue profit. This will result in income tax imbalances at both parties end. Similarly, wrong transfer pricing may lead to wrong payment of excise duty, custom duty /sales tax (if applicable) as well.

TRANSFER PRICING PROVISIONS IN INDIA

Increasing participation of multi-national groups in economic activities in India has given rise to new and complex issues emerging from transactions entered into between two or more enterprises belonging to the same group. Hence, there was a need to introduce a uniform and internationally accepted mechanism of determining reasonable, fair and equitable profits and taxes in India. Accordingly, the Finance Act, 2001 introduced law of transfer pricing in India through Sections 92 to 92F of the Income Tax Act, 1961 which guides computation of the transfer price and suggests detailed documentation procedures. Year 2012 brought a big change in transfer pricing regulations in India whereby government extended the applicability of transfer pricing regulations to specified domestic transactions which are enumerated in Section 92BA. This would help in curbing the practice of transferring profit from a taxable domestic zone to tax free domestic zone.

As stated earlier, the fundamental of transfer pricing provision is that transfer price should represent the arm's length price of goods transferred and services rendered from one unit to another unit.

WHAT IS ARM'S LENGTH PRICE?

In general arm's length price means fair price of goods transferred or services rendered. In other words, the transfer price should represent the price which could be charged from an independent party in uncontrolled conditions. Arm's length price calculation is very important for a company. In case the transfer price is not at arm's length, it may have following consequences

- Wrong performance evaluation
- Wrong pricing of final product (In case where the goods/services are used in the manufacturing of final product)
- Non compliances of applicable laws and thus attraction of penalty provisions.

The same may be explained with the following examples

Company X and Company Y is working under the common umbrella of Mohan & Company. Company X manufactures a product which is raw material for Company Y.

Case	Criteria	Effect on Company X	Effect on Company Y
1	Company X charges price more than the Arm's length price from Company Y	The revenue of company X will increase.	The total cost of company Y will increase. This will result into wrong pricing of its product which may further lead to uncompetitiveness of its product
2	Company X charges price less than the Arm's length price from Company Y	The revenue of company X will decrease. The parent company may close the company X treating it as loss making entity.	The total cost of company Y will decrease. Therefore, the company Y may charge lower price which may lead to loss at an entity level.

3	Company X charges Arm's Length price from Company Y	The revenue of company X will be representing true and fair view of its operation.	Company Y will be paying the price as equivalent to market price of Company X product and its cost will be correct. On the basis of the cost arrived after considering the arm's length price of company X product, company Y will be able to take correct price decision.
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"The concept of associated enterprises and International transaction are very important for applying the transfer pricing provisions. Section 92A and Section 92B deals with these two important concepts of chapter X of Income Tax Act, 1961."

ASSOCIATED ENTERPRISES (AE)

Associated Enterprises has been defined in Section 92A of the Act. It prescribes that "associated enterprise", in relation to another enterprise, means an enterprise—

- (a) Which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or
- (b) In respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

Thus, from above definition we may understand that

The basic criterion to determine an AE is the participation in management, control or capital (ownership) of one enterprise by another enterprise whereby the participation may be direct or indirect or through one or more intermediaries, control may be direct or indirect.

Deemed Associated Enterprises

As per Section 92(2), two enterprises shall be deemed to be associated enterprises if, at any time during the previous year,—

- (a) one enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in the other enterprise; or
- (b) any person or enterprise holds, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in each of such enterprises; or
- (c) a loan advanced by one enterprise to the other enterprise constitutes not less than fifty-one per cent of the book value of the total assets of the other enterprise; or
- (d) one enterprise guarantees not less than ten per cent of the total borrowings of the other enterprise; or
- (e) more than half of the board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of one enterprise, are appointed by the other enterprise; or
- (f) more than half of the directors or members of the governing board, or one or more of the executive directors or members of the governing board, of each of the two enterprises are appointed by the same person or persons; or
- (g) the manufacture or processing of goods or articles or business carried out by one enterprise is wholly

- dependent on the use of know-how, patents, copyrights, trade-marks, licences, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights; or
- (h) ninety per cent or more of the raw materials and consumables required for the manufacture or processing of goods or articles carried out by one enterprise, are supplied by the other enterprise, or by persons specified by the other enterprise, and the prices and other conditions relating to the supply are influenced by such other enterprise; or
 - (i) the goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise, and the prices and other conditions relating thereto are influenced by such other enterprise; or
 - (j) where one enterprise is controlled by an individual, the other enterprise is also controlled by such individual or his relative or jointly by such individual and relative of such individual; or
 - (k) where one enterprise is controlled by a Hindu undivided family, the other enterprise is controlled by a member of such Hindu undivided family or by a relative of a member of such Hindu undivided family or jointly by such member and his relative; or
 - (l) where one enterprise is a firm, association of persons or body of individuals, the other enterprise holds not less than ten per cent interest in such firm, association of persons or body of individuals; or
 - (m) there exists between the two enterprises, any relationship of mutual interest, as may be prescribed

In Summary, two enterprises will be deemed as Associated Enterprises if

Quantum of Interest	Criteria applied for Associated Enterprises
26% or more	Shareholding with voting power – either direct or indirect
51% or more	Advancement of loan by one entity to other constituting certain percentage of the book value of the total assets of the other entity
51% or more	Based on the board of directors appointed by the governing board of the entity in the other
90% or more	Based on the quantum of supply of raw materials and consumables by one entity to the other
10% or more	Total Borrowing Guarantee by one enterprises for other
10% or more	Interest by a firm or association of Person(AOP) or by a body of Individual (BOI) in other firm AOP or firm or BOI

MEANING OF INTERNATIONAL TRANSACTION

International Transaction have been defined vide Section 92B of Income Tax Act. It provides that "International Transaction" means a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises.

Deemed International Transaction

As per Section 92B(2) of Income Tax Act, A transaction entered into by an enterprise with a person other than an associated enterprise shall, for the purposes of sub-section (1), be deemed to be a transaction entered into between two associated enterprises, if there exists a prior agreement in relation to the relevant transaction between such other person and the associated enterprise, or the terms of the relevant transaction are determined in substance between such other person and the associated enterprise.

Finance Act, 2012 has added an explanation for the purpose of Definition 92B and it provides that the expression "international transaction" shall include –

- (a) the purchase, sale, transfer, lease or use of tangible property including building, transportation vehicle, machinery, equipment, tools, plant, furniture, commodity or any other article, product or thing;
- (b) the purchase, sale, transfer, lease or use of intangible property, including the transfer of ownership or the provision of use of rights regarding land use, copyrights, patents, trademarks, licences, franchises, customer list, marketing channel, brand, commercial secret, know-how, industrial property right, exterior design or practical and new design or any other business or commercial rights of similar nature;
- (c) capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance, payments or deferred payment or receivable or any other debt arising during the course of business;
- (d) Provision of services, including provision of market research, market development, marketing management, administration, technical service, repairs, design, consultation, agency, scientific research, legal or accounting service;
- (e) A transaction of business restructuring or reorganization, entered into by an enterprise with an associated enterprise, irrespective of the fact that it has bearing on the profit, income, losses or assets of such enterprises at the time of the transaction or at any future date.

The term intangible assets have also been elaborated and explanation to Section 92B provides that the expression Intangible shall include :

- (a) Marketing related intangible assets, such as, trademarks, trade names, brand names, logos;
- (b) Technology related intangible assets, such as, process patents, patent applications, technical documentation such as laboratory notebooks, technical know-how;
- (c) Artistic related intangible assets, such as, literary works and copyrights, musical compositions, copyrights, maps, engravings;
- (d) Data processing related intangible assets, such as, proprietary computer software, software copyrights, automated databases, and integrated circuit masks and masters;
- (e) Engineering related intangible assets, such as, industrial design, product patents, trade secrets, engineering drawing and schematics, blueprints, proprietary documentation;
- (f) Customer related intangible assets, such as, customer lists, customer contracts, customer relationship, open purchase orders;
- (g) Contract related intangible assets, such as, favourable supplier, contracts, licence agreements, franchise agreements, non-compete agreements;
- (h) Human capital related intangible assets, such as, trained and organized work force, employment agreements, and union contracts;
- (i) Location related intangible assets, such as, leasehold interest, mineral exploitation rights, easements, air rights, water rights;

- (j) Goodwill related intangible assets, such as, institutional goodwill, professional practice goodwill, personal goodwill of professional, celebrity goodwill, general business going concern value;
- (k) Methods, programmes, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists, or technical data;
- (l) Any other similar item that derives its value from its intellectual content rather than its physical attributes.'

The above explanation has added a wide range of Intangibles and the purpose of the explanation is to extend the applicability of Transfer pricing code to all International transaction involving the exchange of Intangibles which are not expressly available for trade .

TRANSFER PRICING – APPLICABILITY TO DOMESTIC TRANSACTIONS

Honourable Supreme court in the case of CIT v. Glaxo SmithKline Asia (P) Ltd., (2010) 195 Taxman 35 (SC) has advised that it needs to be considered whether the regulations should be applied to domestic transactions in cases where such transactions are not revenue-neutral. The facts and ruling of Honourable Supreme Court is following:

CIT v. Glaxo SmithKline Asia (P) Ltd., (2010) 195 Taxman 35 (SC)

Facts

1. Glaxo SmithKline Asia (P) Ltd (GSK) entered into an agreement with Glaxo Smith Kline Consumer Healthcare Ltd ("GSKCH") whereby GSKCH would provide all administrative services relating to marketing, finance, Human Resource (HR) to GSK for cost +5% markup.
2. The AO disallowed a part of the charges reimbursed on the ground that they were excessive and not for business purposes. On appeal by GSK, CIT (Appeals) upheld the decision of AO.
3. GSK appeal to Income Tax Appellate Tribunal (ITAT) and ITAT ruled that AO has no power to disallow any expenditure as excessive or unreasonable unless the case falls within the scope of Section 40A(2). The revenue appeal to high court and revenue appeal was dismissed by High court.
4. For subsequent years AO continued to follow the same approach and GSK continued to get relief from ITAT. Having regard to the delay on the part of revenue to give effect to ITAT order GSK filed a writ petition before the High Court and High court issued direction to the Revenue to issue refund of taxes along with applicable interest.

Supreme Court Ruling

1. The revenue filed a Special Leave Petition (SLP) before the Honorable Supreme Court and Supreme Court held that since the exercise is revenue neutral and both the parties are not related parties in terms of Section 40A(2) of Income tax act, no interference is called for and the SLP filed by the Revenue is dismissed.
2. The honourable Supreme Court then stated that the larger issue is whether Transfer Pricing provisions should be limited to cross-border transactions or whether the Transfer Pricing Regulations be extended to domestic transactions. In domestic transactions, the under-invoicing of sales and over-invoicing of expenses ordinarily will be revenue neutral in nature, except in two circumstances having tax arbitrage such as where one of the related entities is (i) loss making or (ii) liable to pay tax at a lower rate and the profits are shifted to such entity;
3. The Supreme Court further held that the complications arise in cases where the fair market value is required to be assigned to transactions between related parties u/s 40A(2). The Central Board of Direct taxes (CBDT) should examine whether Transfer Pricing provisions can be applied to domestic transactions between related parties u/s 40A(2) by making amendments to the Act. The AO can be empowered to

make adjustments to the income declared by the assessee having regard to the fair market value of the transactions between the related parties and can apply any of the generally accepted methods of determination of arm's length price, including the methods provided under Transfer Pricing provisions. The law can also be amended to make it compulsory for the taxpayer to maintain Books of Accounts and other documents on the lines prescribed in Rule 10D and obtain an audit report from his Chartered Accountant (CA) that proper documents are maintained;

- Finally it was held that though the Court normally does not make recommendations or suggestions, in order to reduce litigation occurring in complicated matters, the question of extending Transfer Pricing regulations to domestic transactions require expeditious consideration by the Ministry of Finance and the CBDT may also consider issuing appropriate instructions in that regard.

SPECIFIED DOMESTIC TRANSACTIONS

Finance Act, 2012 has made a very important change and it has extended the applicability of Transfer Pricing Provisions to specified domestic transaction w.e.f. 1st April, 2012.

The specified domestic party transactions would essentially include payment made by a company to a related person referred to in Section 40A(2)(b) of the Act including payment to a director of the company or any person who has a substantial interest in the company (that is, has a beneficial ownership of shares carrying not less than 20 per cent of voting power); transactions referred to in Section 80A(6) of the Act (for example, transfer of goods or services from a tax-incentivised unit/entity to a non-tax-incentivised unit/entity and vice-versa); and transactions referred to in Section 80IA(8), 80IA(10) and 10AA(9) of the Act (carried out by industrial undertakings, infrastructure companies and units operating in special economic zones).

Section 92BA has been added in Transfer Price Code by Finance Act, 2012 which provides that –

“Specified domestic transaction” in case of an assessee means any of the following transactions, not being an international transaction, namely:–

- Any expenditure in respect of which payment has been made or is to be made to a person referred to in clause (b) of sub-section (2) of section 40A;*
- Any transaction referred to in section 80A;*
- Any transfer of goods or services referred to in sub-section (8) of section 80-IA;*
- Any business transacted between the assessee and other person as referred to in sub-section (10) of section 80-IA;*
- Any transaction, referred to in any other section under Chapter VI-A or section 10AA, to which provisions of sub-section (8) or sub-section (10) of section 80-IA are applicable; or*
- Any other transaction as may be prescribed,*

and where the aggregate of such transactions entered into by the assessee in the previous year exceeds a sum of five crore rupees.’

Thus a specified domestic transaction means a transaction which is covered by criteria as given in section 92BA and the aggregate value of such transactions exceeds ₹5 crore in a year.

TRANSFER PRICING – METHODS

Section 92C of Income Tax Act defines the methods which are to be used in determination of Arm's Length prices for International Transaction and specified domestic transaction. The arm's length price in relation to an international transaction/specified domestic transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of

associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe, namely :-

- (A) Comparable Uncontrolled Price Method (CUP)
- (B) Resale Price Method (RPM)
- (C) Cost Plus Method (CPM)
- (D) Profit Split Method (PSM)
- (E) Transactional Net Margin Method (TNMM)
- (F) Such other method as may be prescribed by the Board.

Various transfer pricing methods which are prescribed by Income Tax Act, 1961 are as under:

(A) COMPARABLE UNCONTROLLED PRICE METHOD

Comparable Uncontrolled Price (“CUP”) method compares the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances.

An Uncontrolled price is the price agreed between the unrelated parties for the transfer of goods or services. If this uncontrolled price is comparable with the price charged for transfer of goods or services between the Associated Enterprises, then that price is Comparable Uncontrolled Price (CUP). This is the most direct method for the determination of the Arms’ length price.

Methods of CUP

CUP can be either

- (a) Internal CUP or
- (b) External CUP

Internal CUP is available, when the tax payer enters into a similar transaction with unrelated parties, as is done with a related party as well. This is considered a very good comparable, as the functions performed, processes involved, risks undertaken and assets employed are all easily comparable – more so, on “an apple to apple basis”.

The external CUP is available if a transaction between two independent enterprises takes place under comparable conditions involving comparable goods or services. For example an independent enterprise buys or sells a similar product, in similar quantities under similar term from / to another independent enterprise in a similar market will be termed as external CUP.

Applicability of the CUP Method

Comparable Uncontrolled Price method is treated as most reliable method of transfer pricing calculation but it is not easy to find the controllable price method easily. The CUP is believed to be the most reliable / best method, if one could identify and map it. CUP method can be applied without any difficulty in following circumstances.

- (1) Interest payment on a loan
- (2) Royalty payment
- (3) Software development where products are often licensed to a third party
- (4) Price charged for homogeneous items like traded goods

(B) RESALE PRICE METHOD

Rule 10B (1) (b) of Income Tax Rules, 1962 prescribes Resale Price method by which,

- A. The price at which property purchased or services obtained by the enterprise from an associated enterprise is resold or are provided to an unrelated enterprise is identified;
- B. Such resale price is reduced by the amount of a normal gross profit margin accruing to the enterprise or to an unrelated enterprise from the purchase and resale of the same or similar property or from obtaining and providing the same or similar services, in a comparable uncontrolled transaction, or a number of such transactions;
- C. The price so arrived at is further reduced by the expenses incurred by the enterprise in connection with the purchase of property or obtaining of services;
- D. The price so arrived at is adjusted to take into account the functional and other differences, including differences in accounting practices, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of gross profit margin in the open market;
- E. The adjusted price arrived at under sub-clause (iv) is taken to be an arms length price in respect of the purchase of the property or obtaining of the services by the enterprise from the associated enterprise.

Example

1. A sold a machine to B (Associated enterprise) and in turn B sold the same machinery to C (an independent party) at sale margin of 30% for ₹2,10,000 but without making any additional expenses and change. Here Arm's length price would be calculated as

$$\begin{aligned}
 \text{Sales price to B} &= 2,10,000 \\
 \text{Gross Margin} &= 10,000 \times 30\% = 63,000 \\
 \text{Transfer price} &= 1,47,000
 \end{aligned}$$

2. A sold a machine to B (Associated enterprise) and in turn B sold the same machinery to C (an independent party) at sale margin of 30% for ₹4,00,000 but B has incurred ₹4,000 in sending the machine to C. Here Arm's length price would be calculated as

$$\begin{aligned}
 \text{Sales price to B} &= 4,00,000 \\
 \text{Gross Margin} &= 4,00,000 \times 30\% = 1,20,000 \\
 \text{Balance} &= 2,80,000 \\
 \text{Less: Expenses incurred by B} &= 4,000 \\
 \text{Arm's length price} &= 2,76,000
 \end{aligned}$$

(C) COST PLUS METHOD

Rule 10B (1) (c) of Income tax Rules, 1962 prescribes Cost Plus Method, by which,

- (i) The direct and indirect costs of production incurred by the enterprise in respect of property transferred or services provided to an associated enterprise, are determined;
- (ii) The amount of a normal gross profit mark-up to such costs (computed according to the same accounting norms) arising from the transfer or provision of the same or similar property or services by the enterprise, or by an unrelated enterprise, in a comparable uncontrolled transaction, or a number of such transactions, is determined;

- (iii) The normal gross profit mark-up so determined is adjusted to take into account the functional and other differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect such profit mark-up in the open market;
- (iv) The costs referred to in sub-clause (i) are increased by the adjusted profit mark-up arrived at under sub-clause (iii);
- (v) The sum so arrived at is taken to be an arm's length price in relation to the supply of the property or provision of services by the enterprise.

Under the Cost Plus Method, an arm's-length price equals the controlled party's cost of producing the tangible property plus an appropriate gross profit mark-up, defined as the ratio of gross profit to cost of goods sold (excluding operating expenses) for a comparable uncontrolled transaction.

The formulas for the transfer price in inter company transactions of products are as follows:

$$TP = COGS \times (1 + \text{mark-up}), \text{ where:}$$

- TP = Transfer Price of a product sold between a manufacturing company and a related company;
- COGS = Cost of goods sold of the manufacturing company
- Cost plus mark-up = gross profit mark-up defined as the ratio of gross profit to cost of goods sold

Gross profit is defined as sales minus cost of goods sold.

As an example, let us assume that the COGS in a transaction between two associated enterprises is ₹ 5,000. Assume that an arm's length gross profit mark-up that Associated Enterprise 1 should earn is 50%. The resulting transfer price between Associated Enterprise 1 and Associated Enterprise 2 is ₹7,500 [i.e. ₹ 5,000 × (1 + 0.50)].

In this method, calculation of cost of goods sold and gross margin are the most important factor.

(D) PROFIT SPLIT METHOD

Rule 10B (1) (d) of Income tax Rules, 1962 prescribes Profit Split Method, which may be applicable mainly in international transactions involving transfer of unique intangibles or in multiple international transactions which are so interrelated that they cannot be evaluated separately for the purpose of determining the arm's length price of any one transaction, by which:

- (i) The combined net profit of the associated enterprises arising from the international transaction in which they are engaged, is determined;
- (ii) The relative contribution made by each of the associated enterprises to the earning of such combined net profit, is then evaluated on the basis of the functions performed, assets employed or to be employed and risks assumed by each enterprise and on the basis of reliable external market data which indicates how such contribution would be evaluated by unrelated enterprises performing comparable functions in similar circumstances;
- (iii) The combined net profit is then split amongst the enterprises in proportion to their relative contributions, as computed above;
- (iv) The profit thus apportioned to the assessee is taken into account to arrive at an arm's length price in relation to the international transaction.

However, the combined net profit as determined in sub-clause (i) may, in the first instance, be partially allocated to each enterprise so as to provide it with a basic return appropriate for the type of international transaction in which it is engaged, with reference to market returns achieved for similar types of transactions by independent enterprises, and thereafter, the residual net profit remaining after such allocation may be split amongst the

enterprises in proportion to their relative contribution in the manner specified under sub-clauses (ii) and (iii), and in such a case the aggregate of the net profit allocated to the enterprise in the first instance together with the residual net profit apportioned to that enterprise on the basis of its relative contribution shall be taken to be the net profit arising to that enterprise from the international transaction.

Two step Approach of Profit Spilt Method

Step 1: Allocation of sufficient profit to each enterprise to provide a basic compensation for routine contributions. This basic compensation does not include a return for possible valuable intangible assets owned by the associated enterprises. The basic compensation is determined based on the returns earned by comparable independent enterprises for comparable transactions or, more frequently, functions.

Step 2: Allocation of residual profit (i.e. profit remaining after step 1) between the associated enterprises based on the facts and circumstances. If the residual profit is attributable to intangible property, then the allocation of this profit should be based on the relative value of each enterprise's contributions of intangible property.

Example on the Profit Split Method (Residual Analysis Approach)

Company A is an Indian Company and deals in telecommunication products. It has developed a Microprocessor and it holds the patent for manufacturing of the microprocessor. Company B which is an overseas subsidiary of Company A is engaged in manufacturing of Mobile equipment at Australia. Company A supply the microprocessor to company B for using it in Mobile equipment and company B in turn after manufacturing the mobile sends the mobile to company "A" in India. Company A sells all the mobile in India.

Both companies contribute to the success of the mobile equipment through their design of the microprocessor and the equipment. As the nature of the products is very advanced and unique, the group is unable to locate any comparable with similar intangible assets. Therefore, neither the traditional methods i.e. CUP Method, RSP Method nor the TNMM is appropriate in this case.

Nevertheless, the group is able to obtain reliable data on hand phone contract manufacturers and equipment wholesalers without unique intangible property in the telecommunication industry. The manufacturers earn a mark-up of 10% while the wholesalers derive a 25% margin on sales.

Company A's and Company B's respective share of profit is determined in 2 steps using the profit split method (residual analysis approach).

Step 1 – Determining the basic return

The simplified accounts of Company A and Company B are shown below:

	Company B (₹ in Lakhs)	Company A (₹ in Lakhs)
Sales	100	125
Cost of Goods Sold	(60)	(100)
Gross Margin	40	25
Sales, General & Administration		
Expenses	(5)	(15)
Operating Margin	35	10

The total operating profit for the group is ₹ 45 Lakhs.

Company B

<i>Particulars</i>	<i>Amount (₹ in Lakhs)</i>
Cost of goods sold	60
Margin @10%	6
Transfer price based on Comparable (without considering Intangibles)	66

Company A

<i>Particulars</i>	<i>Amount (₹ in Lakhs)</i>	<i>Company B (₹ in Lakhs)</i>	<i>Company A (₹ in Lakhs)</i>
Sales to third party customers	125		
Resale margin of wholesalers comparables (without intangibles) @25%	31.25		
Gross Margin	31.25		
		<i>Company B (₹ in Lakhs)</i>	<i>Company A (₹ in Lakhs)</i>
Sales	66		
Cost of Goods Sold	(60)		
Gross Margin	6	6	31.25
Sales, General & Admin			
Expenses	(5)		(15)
Routine operating margin	1	1	16.25

The total operating margin of the group is ₹ 17.25 Lakhs.

Step 2 : Dividing the residual profit

The residual profit of the group is = ₹ 45 Lakhs – ₹ 17.25 Lakhs = ₹ 27.75 Lakhs

On further study of the two companies, two particular expense items, R&D expenses and marketing expenses, are identified as the key intangibles critical to the success of the mobile equipment. The R&D expenses and marketing expenses incurred by each company are:

Company A 12 Lakhs (80%)

Company B 3 Lakhs (20%)

Assuming that the R&D and marketing expenses are equally significant in contributing to the residual profits, based on the proportionate expenses incurred:

Company A's share of residual profit (80% × 27.75)

= ₹ 22.20 Lakhs

Company B's share of residual profit (20% × 27.75)

= ₹ 5.55 Lakhs

Therefore, the adjusted operating profit of

Company A is = ₹ 22.20 L + ₹ 16.25 L = ₹ 38.45 Lakhs

Company B is = ₹ 5.55 + ₹ 1 = ₹ 6.55 Lakhs.

The adjusted tax accounts are as follows:

	<i>Company B</i> (₹ in Lakhs)	<i>Company A</i> (₹ in Lakhs)
Sales	71.55	125
Cost of Goods Sold	(60)	(71.55)
Gross Margin	11.55	53.45
Sales, General & Admin		
Expenses	(5)	(15)
Operating Margin	6.55	38.45

Hence, the transfer price determined using the profit split method (residual analysis approach) should be ₹ 71.55 Lakhs

(E) TRANSACTIONAL NET MARGIN METHOD (TNMM)

Rule 10B (1) (e) of Income Tax Rules, 1962 prescribes, Transactional net margin method, by which,

- (i) The net profit margin realized by the enterprise from an international transaction entered into with an associated enterprise is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise or having regard to any other relevant base;
- (ii) The net profit margin realized by the enterprise or by an unrelated enterprise from a comparable uncontrolled transaction or a number of such transactions is computed having regard to the same base;
- (iii) The net profit margin referred to in (ii) arising in comparable uncontrolled transactions is adjusted to take into account the differences, if any, between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market;
- (iv) the net profit margin realized by the enterprise and referred to in (i) is established to be the same as the net profit margin referred to in (iii);
- (v) The net profit margin thus established is then taken into account to arrive at an arms length price in relation to the international transaction.

Example

Nikhil & Co is an India manufacturer of dishwashers. All Nikhil & Co's dishwashers are sold to an overseas associated enterprise, Company G, and bears Company G's brand. Company G, a household electrical appliances brand name, sells only dishwashers manufactured by Nikhil & Co.

The CUP method is not applied in this case because no reliable adjustments can be made to account for differences with similar products in the market. After the appropriate functional analysis, Nikhil & Co was able to identify an Indian manufacturer of home electrical appliances, Company H, as a suitable comparable company. However, Company H performs warranty functions for its independent wholesalers, whereas Nikhil & Co does not. Company H realizes a net mark up (i.e. operating margin) of 10%.

As the costs pertaining to the warranty functions cannot be separately identified in Company H's accounts and no reliable adjustments can be made to account for the difference in the functions, it may be more reliable to examine the net margins in this case. The transfer price for Nikhil & Co's sale of dishwashers to Company G is computed using the TNMM as follows:

Nikhil & Co's cost of goods sold	₹ 5,000
Nikhil & Co's operating expenses	₹ 1,500
Total costs	₹ 6,500
<i>Add : Net mark up @ 10% (10% x 6,500)</i>	₹ 650
Transfer price based on TNMM	₹ 7,150

SELECTION OF TRANSFER PRICING METHOD

Rule 10C of the Indian Income Tax Rules, 1962 states that:

In selecting a most appropriate method, the following factors shall be taken into account namely,

- (a) The nature and class of the international transaction.
- (b) The class or classes of Associated Enterprises entering into the transaction and the functions performed by them taking into account assets employed or to be employed and risks assumed by such enterprises.
- (c) The availability, coverage and reliability of data necessary for application of the method.
- (d) The degree of comparability existing between the international transaction and the uncontrolled transaction and between the enterprises entering into such transactions.
- (e) The extent to which reliable and accurate adjustments can be made to account for differences, if any, between the international transaction and the comparable uncontrolled transactions or between the enterprises entering into such transactions.
- (f) The nature, extent and reliability of assumptions required to be made in the application of a method.

The starting point to select the most appropriate method is the functional analysis which is necessary regardless of what transfer pricing method is selected. Each method may require a deeper analysis focusing on aspects relating to various methods. The functional analysis helps to:

- Identify and understand the intra-group transactions;
- Have a basis for comparability;
- Determine any necessary adjustments to the comparables;
- Check the accuracy of the method selected; and
- Over time, to consider adaptation of the policy if the functions, risks or assets have been modified.

Functional analysis also forms part of the documentation. The major components of a functional analysis are:

1. *Identification of Functions Performed* : For the purpose of determining comparability, functions of the entities play an important role.
2. *Identification of Risk Undertaken* : A risk-bearing party should have a chance of higher earnings than a non-risk bearing party, and will incur the expenses and perhaps related loss if and when risk materializes.
3. *Identification of Assets used or contributed* : The functional analysis must identify and distinguish tangible assets and intangible assets as this is very important for functional analysis.

The functional analysis provides answers to identify which functions risks and assets are attributable to the various related parties. In some cases one company may perform one function but the cost thereof is incurred/paid by the other party to the transaction. The functional analysis could emphasize that situation. The functional

analysis includes reference to the industry specifics, the contractual terms of the transaction, the economics circumstances and the business strategies. A checklist with columns for each related party and if needed for the comparable parties could be used to summarize the functional analysis and give a quick idea of which party performs each relevant function, uses what assets and bears which risk. But this short-cut overview should not be used by tax auditors to count the number of enumerated functions, risks and assets in order to determine the arm's length compensation. It should be used to consider the relative importance of each function, risk and asset. Once the functional analysis is performed and the functionality of the entity as regards the transactions subject to review (or the entity as a whole) has been completed, it can be determined what transfer pricing method is most suitable to determine the arm's length price for the transactions under the review (or the operating margin for the entity under review).

There is no universally accepted method or model which describes the technique for choosing a transfer pricing method. Traditionally comparable Uncontrolled Pricing Method, Profit Split Method, Resale Price Methods are being used in transfer pricing. Other method as TNMM may also be used after the functional analysis and global practices analysis.

REFERENCE TO TRANSFER PRICING OFFICER

Section 92CA of Income Tax Act deals with Reference to Transfer Pricing Officer by assessing officer.

It provides that Assessing Officer with prior approval of Commissioner may refer the computation of Arm's Length Price in an International Transaction to transfer pricing officer if he considers it necessary or expedient to do so. On reference by Assessing officer, Transfer Pricing Officer (TPO) shall serve a notice to the Assessee requiring him to produce the evidence in support of computation made by him of Arm's Length Price in relation to an International transaction.

WHO IS TRANSFER PRICING OFFICER (TPO)

For the purpose of Section 92CA "Transfer Pricing Officer" means a Joint Commissioner or Deputy Commissioner or Assistant Commissioner authorized by the Board to perform all or any of the functions of an Assessing Officer specified in sections 92C and 92D in respect of any person or class of persons.

DETERMINATION OF ARM'S LENGTH PRICE BY TRANSFER PRICING OFFICER

Transfer Pricing Officer after hearing the evidences, information or documents as produced by assessee and after considering such evidence as he may require on any specified points and after taking into account all relevant materials which he has gathered, shall, by order in writing, determine the arm's length price in relation to the international transaction/specified transaction and send a copy of his order to the Assessing Officer and to the assessee. On receipt of the order from Transfer Pricing officer, the Assessing Officer shall proceed to compute the total income of the assessee in conformity with the arm's length price as determined by the Transfer Pricing Officer.

RECTIFICATION OF ARM'S LENGTH PRICE ORDER BY TRANSFER PRICING OFFICER

If any mistake is observed which is apparent from record, the Transfer Pricing Officer may amend any order passed by him and the provisions of Section 154 w.r.t. rectification of mistake shall apply accordingly. Where any amendment is made by the Transfer Pricing Officer, he shall send a copy of his order to the Assessing Officer who shall thereafter proceed to amend the order of assessment in conformity with such order of the Transfer Pricing Officer.

POWERS OF TRANSFER PRICING OFFICER

1. Power to call evidences/Information from Assessee:

As per Section 92CA(2), the Transfer Pricing Officer may issue a notice to the Assessee and ask him to

furnish records, evidences, information in support of the computation of Arm's Length Price relating to the International Transaction.

2. Power to amend the Order made in regard to computation of Arm length price for the transaction referred to him:

As stated earlier, if any mistake is observed which is apparent from record, the Transfer Pricing Officer may amend any order passed by him and the provisions of section 154 w.r.t. rectification of mistake shall apply accordingly

3. Power to proceed if the report under Section 92E is not furnished for some International transactions:

Finance Act, 2012 has inserted section 92CA(2B) in the Act which provides that w.e.f. 1st June, 2002 if the assessee has not furnished return u/s 92E and the transfer pricing officer observe International transaction or specified domestic transactions during the course of the proceedings before him, he may proceed with deeming that such transaction has been referred to him under this section 92CA provided that the provision of this section shall not empower the Assessing Officer either to assess or reassess under section 147 or pass an order enhancing the assessment or reducing a refund already made or otherwise increasing the liability of the assessee under section 154, for any assessment year, proceedings for which have been completed before the 1st day of July, 2012

4. Power to proceed into the cases not referred to him:

As per amendment made by Finance Act, 2011 the jurisdiction of the Transfer Pricing Officer shall extend to the determination of the Arm's Length Price (ALP) in respect of other international transactions which are noticed by him subsequently, in the course of proceedings before him. These international transactions would be in addition to the international transactions referred to the TPO by the Assessing Officer

5. Power to exercise all of the following powers specified in Sections 131(1)(a) to 131(1)(d) or 133(6) or 133A of Income Tax Act:

Power u/s 131(1)(a) to 131(1)(d)

TPO have the same powers as are vested in a Court under the Code of Civil Procedure, 1908 (5 of 1908), when trying a suit in respect of the following matters, namely:—

- (a) discovery and inspection;
- (b) enforcing the attendance of any person, including any officer of a banking company and examining him on oath;
- (c) compelling the production of books of account and other documents; and
- (d) Issuing commissions.

6. Power u/s 133(6)

Under Section 133(6), TPO may require any person, including a banking company or any officer thereof, to furnish information in relation to such points or matters, or to furnish statements of accounts and affairs verified in the manner specified by him giving information in relation to such points or matters as his opinion will be useful for, or relevant to, any enquiry or proceeding under this Act.

7. Power u/s 133A - Power of Survey

Finance Act, 2011 has made an amendment which provides for the power of Survey to TPO through introduction of Section 133A. In course of the proceedings, a TPO may carry out the survey as per section 133A of Income Tax Act.

ADVANCE PRICING AGREEMENT

As per Section 92CC of Income Tax Act, 1961, w.e.f. 1st July, 2012, the Central Board of Direct Taxes (Board), with the approval of the Central Government, may enter into an Advance Price Agreement with any person, determining the arm's length price or specifying the manner in which arm's length price is to be determined, in relation to an international transaction to be entered into by that person.

Advance Pricing Agreement (APA) is an agreement between a taxpayer and a taxing authority (Board) on an appropriate transfer pricing methodology for fixing the arm's length price for a set of transactions over a fixed period of time in future. Importance of APA may be understood with the fact that in financial year 2011-2012, addition of about ₹ 40,000 crore income has been proposed by Transfer pricing officers.

CALCULATION OF ARM'S LENGTH PRICE UNDER ADVANCE PRICING AGREEMENT

Arm's Length Price under Advance Pricing Agreement shall be calculated as per method enumerated in section 92C (1) or any other method with such adjustment and variation as may be necessary and expedient so to do.

Section 92 C (1) of Income Tax Act prescribes that the arm's length price in relation to an international transaction shall be determined by any of the following methods, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons or functions performed by such persons or such other relevant factors as the Board may prescribe (see rule 10B) namely:—

- (a) Comparable uncontrolled price method;
- (b) Resale price method;
- (c) Cost plus method;
- (d) Profit split method;
- (e) Transactional net margin method;
- (f) Such other method as may be prescribed by the Board.

Notwithstanding anything contained in Section 92C or Section 92CA, if the Advance Pricing Agreement has been entered between an assessee and Board in respect of one international transaction, the arm's length price will be calculated as per the provisions of Advance Pricing Agreement.

VALIDITY OF ADVANCE PRICING AGREEMENT

The Advance Pricing Agreement shall be valid for a period as specified in the Advance Pricing Agreement. However, this period will not be more than 5 consecutive years.

BINDINGNESS OF ADVANCE PRICING AGREEMENT

Advance Pricing Agreement shall be binding on:

- (a) the person in whose case, and in respect of the transaction in relation to which, the agreement has been entered into; and
- (b) on the Commissioner, and the income-tax authorities subordinate to him, in respect of the said person and the said transaction

However the advance pricing agreement shall not be binding if there is a change in law or facts having bearing on the agreement so entered.

DECLARING AN ADVANCE PRICING AGREEMENT VOID AB INITIO

The Board may, with the approval of the Central Government, by an order, declare an agreement to be void ab initio, if it finds that the agreement has been obtained by the person by fraud or misrepresentation of facts.

EFFECT OF DECLARING AN ADVANCE PRICING AGREEMENT VOID AB INITIO

If an agreement is declared void ab initio –

- (a) All the provisions of the Act shall apply to the person as if such agreement had never been entered into; and
- (b) Notwithstanding anything contained in the Act, for the purpose of computing any period of limitation under this Act, the period beginning with the date of such agreement and ending on the date of order for declaring an Advance Pricing Agreement void ab initio shall be excluded. Provided that where immediately after the exclusion of the aforesaid period, the period of limitation, referred to in any provision of this Act, is less than sixty days, such remaining period shall be extended to sixty days and the aforesaid period of limitation shall be deemed to be extended accordingly.

PROCEDURE AND SCHEME OF ADVANCE PRICING AGREEMENT

The Board may, for the purposes of this section, prescribe a scheme specifying therein the manner, form, procedure and any other matter generally in respect of the Advance Pricing Agreement. Where an application is made by a person for entering into Advance Pricing Agreement, the proceeding shall be deemed to be pending in the case of the person for the purposes of the Act.

FILING OF MODIFIED RETURN FOR ANY ASSESSMENT YEAR RELEVANT TO A PREVIOUS YEAR TO WHICH APA APPLIES

As per Section 92CD of Income Tax Act, 1961, w.e.f. 1st July, 2012 notwithstanding anything to the contrary contained in Section 139, where any person has entered into an agreement and prior to the date of entering into the agreement, any return of income has been furnished under the provisions of Section 139 for any assessment year relevant to a previous year to which such agreement applies, such person shall furnish, within a period of three months from the end of the month in which the said agreement was entered into, a modified return in accordance with and limited to the agreement. Save as otherwise provided in Section 92CD, if modified return is furnished under Section 139, all other provision of the Act shall apply accordingly.

Thus, Section 92CD provides an opportunity to taxpayer to avoid the litigation even for the years for which return has already been filed.

Reassessment of Total Income in the cases where Modified return has been filed but the Assessment/Reassessment proceedings have been completed before the expiry of period allowed for furnishing of modified return

As per Section 92CD(3), if the assessment or reassessment proceedings for an assessment year relevant to a previous year to which the agreement applies have been completed before the expiry of period allowed for furnishing of modified return under Section 92CD , the Assessing Officer shall, in a case where modified return is filed under this Section, proceed to assess or reassess or recompute the total income of the relevant assessment year having regard to and in accordance with the agreement.

Application of APA in the pending assessment or reassessment for an assessment year relevant to the previous year to which the agreement applies and modified return has been filed under Section 92 CD.

Where the assessment or reassessment proceedings for an assessment year relevant to the previous year to which the agreement applies are pending on the date of filing of modified return in accordance with the provisions of sub-section (1), the Assessing Officer shall proceed to complete the assessment or reassessment proceedings in accordance with the agreement taking into consideration the modified return so furnished.

Extension of Limitation Period in the cases where modified return is filed under Section 92CD

As per Section 92CD (5), notwithstanding anything contained in Section 153 or Section 153B or Section 144C –

- (a) The order of assessment, reassessment or recomputation of total income under Section 92CD (3) shall be passed within a period of one year from the end of the financial year in which the modified return under sub-section (1) is furnished;
- (b) The period of limitation as provided in Section 153 or Section 153B or Section 144C for completion of pending assessment or reassessment proceedings referred to Section 92CD(4) shall be extended by a period of twelve months.

This may be observed from above provision that Advance Pricing Agreement, although styled as "advance" agreements, may be a good arm in the resolution of transfer pricing issues pending from prior years—and in some cases it can provide an effective means for resolving existing transfer pricing audits or adjustments.

By virtue of Advance Pricing Agreement, the taxpayer is assured about the Tax Liability arising out of International transaction. No surprises or challenges will arise if the agreement is followed. The scope of certainty includes tax treatment of covered transactions as to amount and characterization, elimination of potential penalties for substantial tax understatement and a limitation of record-keeping requirements.

TRANSFER PRICING – DOCUMENTATION

The legal framework for maintenance of information and documentation by a taxpayer is provided in Section 92D of Income Tax Act, 1961 which lays down that every person who enters into an international transaction with an associated enterprise shall maintain prescribed information and documents. The various types of information and documents to be maintained in respect of an international transaction, the associated enterprise and the transfer pricing method used are prescribed in Rule 10D of the Income Tax Rules, as under:

- (a) A description of the ownership structure of the enterprise and details of shares or other ownership interest held therein by other enterprises;
- (b) A profile of the multinational group of which the assessee enterprises i.e. taxpayer is a part and the name, address, legal status and country of tax residence of each of the enterprises comprised in the group with whom international transactions have been made by the taxpayer and the ownership linkages among them;
- (c) A broad description of the business of the taxpayer and the industry in which it operates and the business of the associated enterprises;
- (d) The nature, terms and prices of international transaction entered into with each associated enterprise, details of property transferred or services provided and the quantum and the value of each such transaction or class of such transaction;
- (e) A description of the functions performed, risks assumed and assets employed or to be employed by the taxpayer and by the associated enterprise involved in the international transaction;
- (f) A record of the economic and market analysis, forecasts, budgets or any other financial estimates prepared by the taxpayer for its business as a whole or separately for each division or product which may have a bearing on the international transaction entered into by the taxpayer;
- (g) A record of uncontrolled transactions taken into account for analysing their comparability with the international transaction entered into, including a record of the nature, terms and conditions relating to any uncontrolled transaction with third parties which may be relevant to the pricing of the international transactions;
- (h) A record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant international transaction;
- (i) A description of the methods considered for determining the arm's length price in relation to each

international transaction or class of transaction, the method selected as the most appropriate method along with explanations as to why such method was so selected, and how such method was applied in each case;

- (j) A record of the actual working carried out for determining the arm's length price, including details of the comparable data and financial information used in applying the most appropriate method and adjustments, if any, which were made to account for differences between the international transaction and the comparable uncontrolled transactions or between the enterprises entering into such transaction;
- (k) The assumptions, policies and price negotiations if any which have critically affected the determination of the arm's length price;
- (l) Details of the adjustments, if any made to the transfer price to align it with arm's length price determined under these rules and consequent adjustment made to the total income for tax purposes;
- (m) Any other information, data or document, including information or data relating to the associated enterprise, which may be relevant for determination of the arm's length price.

Rule 10D also prescribes that the above information is to be supported by authentic documents which may include the following:

- (a) Official publications, reports, studies and data bases of the government of the country of residence of the associated enterprise or of any other country;
- (b) Reports of market research studies carried out and technical publications of institutions of national or international repute;
- (c) Publications relating to prices including stock exchange and commodity market quotations;
- (d) Published accounts and financial statements relating to the business of the associated enterprises;
- (e) Agreements and contracts entered into with associated enterprises or with unrelated enterprises in respect of transaction similar to the international transactions;
- (f) Letters and other correspondence documenting terms negotiated between the taxpayer and associated enterprise;
- (g) Documents normally issued in connection with various transaction under the accounting practices followed.

BURDEN OF PROOF

It is noteworthy that the information and documentation requirements referred to above are linked to the burden of proof laid on the taxpayer to prove that the transfer price adopted is in accordance with the arm's length principle. One of the conditions to be fulfilled for discharging this burden by the taxpayer is maintenance of prescribed information and documents in respect of an international transaction entered into with a associated enterprise. A default in maintaining information and documents in accordance with the rules is one of the conditions which may trigger a transfer pricing audit under Section 92C(3). Any default in respect of the documentation requirement may also attract penalty of a sum equal to two percent of the value of the international transaction (Sec 271AA).

SUBMISSION OF DOCUMENTS WITH THE TAX AUTHORITIES

There is no reference in the provisions included either in the Income Tax Act or the Income Tax Rules about any requirement to submit the prescribed information and documents at the stage of initial compliance in the form of submission of report under Section 92E. All that Section 92E requires is that the concerned taxpayer shall obtain a Report from an Accountant in the prescribed form (Form 3CEB) and submit the Report by the specified date.

Form 3CEB contains a certificate from the Accountant that in his opinion proper information and documents as prescribed have been maintained by the taxpayer. Rule 10D requires that the information and document maintained should be contemporaneous as far as possible and should exist latest by the specified date for filing the report under Section 92E. Section 92D also provides that information and documentation may be requisitioned by the Assessing Officer or the Appellate Commissioner on a notice of thirty days which period may be extended by another period of 30 days.

NON APPLICABILITY OF DOCUMENTATION REQUIREMENT

Although the law has prescribed no monetary limit in respect of international transaction covered by the transfer pricing requirements, an exception is provided in para 2 of Rule 10D in respect of the maintenance of information and document requirement in respect of international transactions not exceeding ₹ 100 Lakhs. It is provided that the above requirement will not apply to such transactions. However, the concerned taxpayer may be required to substantiate on the basis of available material that the income arising from the international transaction is computed in accordance with the arm's length rule.

RETENTION PERIOD OF DOCUMENTS KEPT UNDER RULE 10D

The prescribed information and documents are required to be maintained for a period of six years from the end of the relevant Assessment years thus the information and documents are required to be maintained for a period of eight years. Rule 10D absolves a taxpayer entering into an international transaction which continues to have effect over more than one year from maintaining separate set of documents for each year. However separate documents are required for each year if there is any significant change in the terms and conditions of the international transaction which have a bearing on the transfer price.

TRANSFER PRICING – PENALTY FOR CONTRAVENTION

Contravention of Transfer Pricing provisions as contained in Chapter X of the Income tax Act, 1961 may invite hefty penalties. The details of penalties under different sections of Income tax Act, 1961 are as follows :-

A. Penalty for concealment of income or for furnishing inaccurate particulars of such income under Section 271(1)(c)

If the Assessing Officer or Commissioner (Appeals) or the Commissioner in the course of any proceedings under this Act, is satisfied that any person has concealed the particulars of his income or furnished inaccurate particulars of such income, he may direct that such person shall pay by way of penalty in addition to tax, if any, payable by him, a sum which shall not be less than, but which shall not exceed three times, the amount of tax sought to be evaded by reason of the concealment of particulars of his income or the furnishing of inaccurate particulars of such income.

Explanation 7 to Section 271(1)(c) - Where in the case of an assessee who has entered into an international transaction defined in section 92B, any amount is added or disallowed in computing the total income under sub-section (4) of section 92C, then, the amount so added or disallowed shall, for the purposes of clause (c) of this sub-section, be deemed to represent the income in respect of which particulars have been concealed or inaccurate particulars have been furnished, unless the assessee proves to the satisfaction of the Assessing Officer or the Commissioner (Appeals) or the Commissioner that the price charged or paid in such transaction was computed in accordance with the provisions contained in section 92C and in the manner prescribed under that Section, in good faith and with due diligence.

B. Penalty for failure to furnish information or document - Section 271G

As per Section 271G of Income Tax Act, If any person who has entered into an international transaction fails to furnish any such information or document as required by sub-section (3) of section 92D, the

Assessing Officer or the Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to two per cent of the value of the international transaction for each such failure.

C. Penalty for failure to keep and maintain information and document in respect of International transaction - Section 271AA

Without prejudice to the provisions of Section 271 or Section 271BA, if any person in respect of an International transaction Fails to keep and maintain any such information and document as required by sub-section (1) or sub-section (2) of Section 92D.

The Assessing Officer or Commissioner (Appeals) may direct that such person shall pay, by way of penalty, a sum equal to two per cent of the value of each international transaction entered into by such person.

D. Penalty for failure to furnish report under Section 92E - Section 271BA

If any person fails to furnish a report from an accountant as required by Section 92E, the Assessing Officer may direct that such person shall pay, by way of penalty, a sum of one hundred thousand rupees.

E. Penalty for failure to answer questions, sign statements, furnish information, returns or statements etc. - Section 272A

If any person,-

- (a) being legally bound to state the truth of any matter touching the subject of his assessment, refuses to answer any question put to him by an income-tax authority in the exercise of its powers under this Act; or
- (b) refuses to sign any statement made by him in the course of any proceedings under this Act, which an income-tax authority may legally require him to sign; or
- (c) to whom a summons is issued under sub-section (1) of Section 131 either to attend to give evidence or produce books of account or other documents at a certain place and time omits to attend or produce books of account or documents at the place or time, he shall pay, by way of penalty, a sum of ten thousand rupees for each such default or failure.

LESSON ROUND UP

Tax Haven: A Tax Haven is a place where there is no tax on income or it is taxed at low rate. Individuals or corporate entities move from jurisdiction of high rates of taxes to the region of low tax in order to lower their overall tax liability.

Factors for determining whether a country is tax haven or not are: Nil or Nominal tax Rate, No Exchange of Information, Lack of Transparency, Limited Regulatory supervision.

Controlled foreign Corporation: The OECD recommended for adoption of CFCs Rules for taxing those entities which defer the tax liability after moving to the tax haven country. A CFC is a legal entity that exists in one jurisdiction but is owned or controlled primarily by taxpayers of a different jurisdiction. The CFC rules may also be termed 'anti-deferral rules'.

Sub Part F means special category of foreign source unearned income that is currently taxed by the Internal Revenue Code, 1986 of US whether or not it is remitted to the U.S. It is basically U.S. financial term used for the U.S. based institutions.

Residency Issue : Residence as defined in double taxation treaties is different from residence as defined for domestic tax purposes. The situation of double taxation will arise where the income gets taxed in two or more than two countries whether due to residency or source principle as the case may be. The problem of double

taxation arises if the income of a person is taxed in one country on the basis of residence and on the basis of residency in another country or on the basis of both.

Permanent Establishment: as per the Double Taxation Avoidance Agreements, PE includes, a wide variety of arrangements i.e. a place of management, a branch, an office, a factory, a workshop or a warehouse, a mine, a quarry, an oilfield etc. Imposition of tax on a foreign enterprise is done only if it has a PE in the contracting state.

Transfer Pricing Provisions in India: The Finance Act, 2001 introduced law of transfer pricing in India through Sections 92 to 92F of the Income Tax Act, 1961 which guides computation of the transfer price and suggests detailed documentation procedures.

Arm's length price means fair price of goods transferred or services rendered. In other words, the transfer price should represent the price which could be charged from an independent party in uncontrolled conditions. Arm's length price calculation is very important for a company.

Associated Enterprises has been defined in Section 92A of the Act. It prescribes that "associated enterprise", in relation to another enterprise, means an enterprise –

- (a) Which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or
- (b) In respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

"International Transaction" means a transaction between two or more associated enterprises, either or both of whom are non-residents, in the nature of purchase, sale or lease of tangible or intangible property, or provision of services, or lending or borrowing money, or any other transaction having a bearing on the profits, income, losses or assets of such enterprises, and shall include a mutual agreement or arrangement between two or more associated enterprises for the allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided to any one or more of such enterprises.

Specified Domestic transactions: Finance Act, 2012 has made a very important change and it has extended the applicability of Transfer Pricing Provisions to specified domestic transaction w.e.f. 1st April, 2012.

Methods for determination of Arm's Length Price: Section 92C of Income Tax Act defines the methods which are to be used in determination of Arm's Length prices for International Transaction and specified domestic transaction.

- (A) Comparable Uncontrolled Price Method (CUP)
- (B) Resale Price Method (RPM)
- (C) Cost Plus Method (CPM)
- (D) Profit Split Method (PSM)
- (E) Transactional Net Margin Method (TNMM)
- (F) Such other method as may be prescribed by the Board.

Reference to TPO: Section 92CA of Income Tax Act deals with Reference to Transfer Pricing Officer by assessing officer. It provides that Assessing Officer with prior approval of Commissioner may refer the computation of Arm's Length Price in an International Transaction to transfer pricing officer if he considers it necessary or expedient to do so.

Advance Pricing Agreement: As per Section 92CC of Income Tax Act, 1961, w.e.f. 1st July, 2012, the Central Board of Direct Taxes (Board), with the approval of the Central Government, may enter into an Advance Price Agreement with any person, determining the arm's length price or specifying the manner in which arm's length price is to be determined, in relation to an international transaction to be entered into by that person. Advance Pricing Agreement (APA) is an agreement between a taxpayer and a taxing authority(Board) on an appropriate transfer pricing methodology for fixing the arm's length price for a set of transactions over a fixed period of time in future.

Documentation: The legal framework for maintenance of information and documentation by a taxpayer is provided in Section 92D of Income Tax Act, 1961 which lays down that every person who enters into an international transaction with an associated enterprise shall maintain prescribed information and documents.

Certificate: Form 3CEB contains a certificate from the Accountant that in his opinion proper information and documents as prescribed have been maintained by the taxpayer.

Penalty: Contravention of Transfer Pricing provisions as contained in Chapter X of the Income tax Act, 1961 may invite hefty penalties.

SELF TEST QUESTIONS

These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation.

ELABORATIVE

1. What are tax havens in relation to International Taxation?
2. What is Transfer pricing? Explain it in relation to the provisions of the Income Tax Act 1961.
3. What do you mean by Subpart F and CFC?
4. Discuss briefly the Subpart F income and operating rules.
5. What are the relevant provisions regarding to DTAA in India?
6. What are entry options available for foreign companies planning to set up business operations in India? Explain briefly.
7. Discuss the scope of the provisions the Central Government may make under section 90(A)(1) of the Income-tax Act, 1961 in respect of an agreement between specified associations.
8. Discuss the steps for calculating relief under double taxation treaty.
9. Distinguish between 'international transactions' and 'cross border transactions'.
10. Explain, with the help of a simple example, the determination of arm's length price where more than one such price is arrived at by the Transfer Pricing Officer by following the most appropriate method.
11. If a tax payer has legitimately reduced his tax burden by taking advantage of treaty, the benefit cannot be denied to him on the ground of loss of revenue. Explain in the context of decided case law.
12. A resident of India has paid tax in a foreign country in respect of his income which accrued in that country. India has no double taxation avoidance agreement with that country. Such income is also taxable in India. Is there any relief available to him in respect of the tax paid by him? Explain.
13. Explain how the arm's length price in relation to an international transaction is computed under the comparable uncontrolled price method as per Rule 10B of the Income-tax Rules, 1962.

PRACTICAL QUESTIONS

1. You are a tax consultant to an overseas manufacturing company which is going to start a permanent establishment in India with manufacturing facility in Madurai District of Tamilnadu. Prepare a report for the Chairman of the company highlighting latest transfer pricing provisions applicable in India.
 2. Compute the 'arm length price' (ALP) in the following cases :
 - (a) Medical Instruments Ltd. is a 100% Indian subsidiary of a US company. The parent company sells one of its products to the Indian subsidiary at a price of US\$ 100 per unit. The same product is sold to unrelated buyers in India at a price of US\$ 125 per unit.
 - (b) The US parent company sells the same product to an unrelated company in India @ US\$ 80 per unit.

ANSWERS/HINTS

Practical Questions

2. (a) Nil; (b) 80 US\$;

SUGGESTED READINGS

1. Dr. V.K. Singhania : Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.
 2. Girish Ahuja and Ravi Gupta : Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.
 3. Dr. V.K. Singhania & Dr. Kapil Singhania : Professional Approach to Direct Taxes Law & Practice; Bharat Law House, New Delhi.
 3. Dr. V.K. Singhania & Dr. Kapil Singhania : Direct Taxes Law & Practice; Taxmann Publications Pvt. Ltd., New Delhi.

Lesson 16

Advance Ruling and GAAR

LESSON OUTLINE

- Concept of advance ruling
 - Who can seek advance ruling?
 - Authority for advance ruling:
 - Application for advance ruling
 - Powers of the authority
 - Applicability of advance ruling (section 245-S)
- General anti-avoidance rules (GAAR)
 - GAAR in India
 - GAAR versus SAAR
- Lesson Round Up
- Self Test Questions

LEARNING OBJECTIVES

The concept of advance rulings under the Act was introduced by the Finance Act, 1993, Chapter XIX-B of the Act, which deals with advance rulings, came into force with effect from 1.6.1993. Under the scheme, the power of giving advance rulings has been entrusted to an independent adjudicatory body designated, as Authority for Advance Rulings (AAR). Accordingly, a high level body headed by a retired judge of the Supreme Court has been set-up. There are two members in the body. AAR is empowered to give rulings, which are binding both on the Income-tax Department and the applicant. Afterwards, the proposed General Anti Avoidance Rule will be discussed.

At the end of this lesson, you will

- Aware about the provisions of advance ruling
- Know who can make an application for advance ruling
- Understand the applicability of advance ruling
- Have an idea of General Anti Avoidance Rules and how they are different from Specific Anti Avoidance Rules.

In order to provide the facility of ascertaining the Income-tax liability of a non-resident, to plan their Income-tax affairs well in advance and to avoid long drawn and expensive litigation, a scheme of Advance Ruling has been introduced under the Income-tax Act, 1961. A non-resident or certain categories of resident can obtain binding rulings from the Authority for advance Ruling on question of law or fact arising out of any transaction/proposed transactions which are relevant for the determination of his tax liability.

CONCEPT OF ADVANCE RULING

With a view to avoiding a dispute in respect of assessment of income-tax liability in the case of a '**Non-Resident**', a Scheme of Advance Ruling has been introduced by incorporating Chapter XIX-B in the Income Tax Act, 1961 by the Finance Act, 1993. The Scheme enables the '**Non-Residents**' to obtain in advance, a binding ruling from the Authority for Advance Rulings on issues, which could arise in determining their tax liabilities.

The term advance ruling has been defined in section 245N of the Act. "Advance ruling" means,

- (i) a determination by the Authority in relation to a transaction which has been undertaken or is proposed to be undertaken by a **non-resident applicant**; or
- (ii) a determination by the Authority in relation to the **tax liability of a non-resident** arising out of a transaction which has been undertaken or is proposed to be undertaken by a **resident applicant with such non resident** and such determination shall include the determination of any question of fact specified in the application,
- (iii) a determination or decision by the Authority in respect of an **issue** relating to **computation of total income** which is **pending** before any **income-tax authority** or the **Appellate Tribunal**,
- (iv) a determination or decision by the Authority whether an arrangement, which is proposed to be undertaken by any person being a resident or a non-resident, is an impermissible avoidance agreement as referred to in Chapter X-A or not. (Inserted by Finance Act, 2013, w.e.f. 1-4-2015).

Further, advance ruling may be determined for both the question of law or fact.

WHO CAN SEEK ADVANCE RULING?

As per Section 245N(b) of the Income Tax Act, the advance ruling under the income-tax act could be sought by:

- (a) A non-resident;
- (b) Resident having transactions with non-residents.
- (c) Specified categories of residents.

AUTHORITY FOR ADVANCE RULING

Under the scheme of Advance Ruling, the power of giving advance rulings has been entrusted to an independent adjudicatory body designated, as Authority for Advance Rulings (AAR). The AAR consists of the following members who are appointed by the Indian Government:

1. A Chairman who is a retired judge of the Supreme Court;
2. An officer of the Indian Revenue Service (IRS) who is qualified to be a member of the Central Board of Direct Taxes;
3. An officer of the Indian Legal Service who is, or is qualified to be, an Additional Secretary to the Government of India.

This Authority is a quasi-judicial body having full powers of a civil court under the Income-tax Act to give its rulings in respect of specific questions of law or fact.

All the three Members of the Authority function as a body in disposing off the applications before them. However, section 245P makes it clear that no proceeding before the Authority, or the pronouncement of advance ruling by the Authority, shall be questioned or shall be invalid on the ground merely of the existence of any vacancy or defect in the Constitution of the Authority.

Under Rule 27 of the AAR Procedure Rules, 1996 the proceedings of the Authority shall be conducted in the following manner :

- (1) When one or both of the members of the Authority other than Chairman is unable to discharge his functions owing to absence, illness or any other cause or in the event of occurrence of any vacancy or vacancies in the office of the members and the case cannot be adjourned for any reason, the Chairman alone or the Chairman and the remaining member may function as the Authority.
- (2) Subject to the provisions of sub-rule (3), in case there is difference of opinion among the members hearing an application the opinion of the majority of members shall prevail and orders of the Authority shall be expressed in terms of the views of the majority but any member dissenting from the majority view may record his reasons separately.
- (3) Where the Chairman and one other member having a case under sub-rule (1) are divided in their opinions, the opinion of the Chairman shall prevail.

APPLICATION FOR ADVANCE RULING

The application for advance ruling shall be made in quadruplicate and it should be accompanied by a fee of ten thousand rupees stating the question on which the advance ruling is sought. An applicant may withdraw an application within thirty days from the date of the application.

(a) Forms

The application may be withdrawn within 30 days from the date of the application.

- 34C Applicable for a non-resident applicant.
- 34D Applicable for a resident having transactions with a non-resident
- 34E Applicable for the notified residents.

(b) Procedure on Receipt of Application

On receipt of an application, the Authority shall forward one copy of the application to the Commissioner having jurisdiction over the case of the applicant and, if considered necessary by the Authority, relevant records can also be obtained from the Commissioner. In cases where the applicants are not existing assesses, sometimes it becomes difficult to determine as to which Commissioner would have jurisdiction over the case of the applicant. In such cases, the Central Board of Direct Taxes (CBDT) is to be requested under Rule 13(1) of the Procedure Rules to designate a Commissioner in respect of an applicant within two weeks. The designated Commissioner is also called upon to offer his comments on the contents of the application under Rule 13(2) of the Procedure Rules, which are considered by the Authority along with the statement of facts and submissions of the applicant.

Section 254R(2) of the Income Tax Act provides that the Authority may, after examining the application and the records called for, either 'allow' or 'reject' the application. The word 'allow' has been used synonymously with 'admit'. In other words, after examining the records, the Authority either admits or rejects the application. In case Authority has admitted the application, it is empowered to collect or receive additional material and it will examine all the material thus available to it at the time of hearing and pronouncing a ruling on the application. In case the application has been rejected then an opportunity of being heard must be given to the assessee.

The authority shall pass the ruling in writing within six months of the receipt of application and the copy of the order thereof, shall be sent to the commissioner and assessee.

(c) Salient Features of the Scheme of Advance Ruling

- (a) Available for Income-tax, Customs and Central Excise:

The benefit of advance ruling is available under the Income Tax Act, 1961, Central Excise Act, 1944 and Customs Act, 1962.

- (b) Must relate to a transaction entered into or proposed to be entered into by the applicant.

(c) Questions on which ruling can be sought :

- (i) Even though the word used in the definition is singular namely "question", it is clear that there can be more than one question in one application. This has been made amply clear by Column No.8 of the Form of application for obtaining an advance ruling (Form No.34C).
- (ii) a question can be both of law or fact, pertaining to the income tax liability of the non-resident *qua* the transaction undertaken or proposed to be undertaken.
- (iii) The questions may be on points of law as well as on facts or could be mixed questions of law and facts. There should be so drafted that each question is capable of an answer. This may need breaking-up of complex questions into two or more simple questions.
- (iv) The questions should arise out of the statement of facts given with the application. No ruling will be given on a purely hypothetical question. Question not specified in the application can be raised during the course of hearing. Normally a question is not allowed to be amended but in deserving cases AAR may allow amendment of one or more questions.
- (v) Subject to the limitations to be presently referred to, the question may relate to any aspect of the non-resident's liability including international aspects and aspects governed by double tax avoidance agreements. The questions may even cover aspects of allied laws that may have a bearing on tax liability such as the law of contracts, the law of trusts etc., but the question must have a direct bearing, on and nexus with the interpretation of the Indian Income-tax Act.

POWERS OF THE ADVANCE RULING AUTHORITY

Section 245U deals with the Powers of the Authority. Sub-section (1) provides that for the purpose of exercising its powers, the Authority shall have all the powers of a Civil Court under the Code of Civil Procedure, 1908 (5 of 1908) as are referred to in Section 131 of the Income-tax Act, when trying a suit in respect of the following matters, namely :

- (a) Discovery and inspection;
- (b) Enforcing the attendance of any person, including any officer of a banking company and examining him on oath;
- (c) Compelling the production of books of account and other documents; and
- (d) Issuing commissions.

Under sub-section (2) the Authority shall be deemed to be a Civil Court for the purposes of Section 195 of the Code of Criminal Procedure. Section 195 deals with 'Prosecution for contempt of lawful authority of public servants, for offences against public justice and for offences relating to documents given in evidence'. But it would not be deemed to be a Court for the purposes of Chapter XXVI of the Code of Criminal Procedure which deals with 'Provisions as to offences affecting the administration of justice'. Further, every proceeding before the authority shall be deemed to be a judicial proceeding within the meaning of Sections 193 and 228, and for the purpose of Section 196 of the Indian Penal Code. Section 193 deals with punishment for false evidence and the same is reproduced below :

"193 : Whoever intentionally gives false evidence in any stage of a judicial proceeding, or fabricates false evidence for the purpose of being used in any stage of a judicial proceeding, shall be punished with imprisonment of either description for a term which may extend to seven years, and shall also be liable to fine; and whoever intentionally gives or fabricates false evidence in any other case, shall be punished with imprisonment of either description for a term which may extend to three years, and shall also be liable to fine."

Section 228 of the Indian Penal Code deals with intentional insult or interruption to public servant sitting in

judicial proceeding and the same is reproduced as below:

“228 : Whoever intentionally offers any insult, or causes any interruption to any public servant, while such public servant is sitting in any stage of a judicial proceeding, shall be punished with simple imprisonment for a term which may extend to six months, or with fine which may extend to one thousand rupees, or with both”.

Section 196 of the I.P.C. deals with ‘using evidence known to be false’ and is set-out as follows :

“196 : Whoever corruptly uses or attempts to use as true or genuine evidence any evidence which he knows to be false or fabricated, shall be punished in the same manner as if he gave or fabricated false evidence.”.

Thus, the authority would have all the powers of the Civil Court for the purposes of dealing with intentional insult, false evidence etc.

APPLICABILITY OF ADVANCE RULING (SECTION 245-S)

The advance ruling pronounced by the Authority under Section 245R shall be binding only :

- (a) *On the applicant who had sought it;*
- (b) *In respect of the transactions in relation to which the ruling had been sought; and*
- (c) *On the Commissioner, and the income-tax authorities subordinate to him, in respect of the applicant and the said transaction.”*

The effect of the ruling is, understandably, stated to be confined to the applicant who has sought it as well as the Commissioner and the income-tax authority subordinate to him having jurisdiction over the case and that too only in relation to transaction for which advance ruling was sought. It may, however, be stated that the Authority generally follows the ruling in other cases on materially similar facts and, most certainly in other cases raising the same question of law, if any, which it has decided. The rule here is different from the position in other countries where either the taxpayer or the revenue or both are at liberty to accept the ruling or not.

QUESTION PRECLUDED

Under Section 254R, certain restrictions have been imposed on the admissibility of an application for advance ruling, if the question concerned is pending before other authorities. According to it, the authority shall not allow an application where the question raised by the non-resident applicant (or a resident applicant having transaction with a non-resident) is already pending before any income-tax authority or appellate tribunal or any court of law. However, exception has been provided in cases of resident applicants falling in sub-clause (iii) of Clause (b) of Section 245N in cases of pending before income tax authorities or the Tribunal. Further, the authority shall not allow the application where the question raised in it:

- (i) Involves determination of fair market value of any property; or
- (ii) It relates to a transaction or issue which is designed *prima facie* for the avoidance of income-tax.

THE BENEFITS OF OBTAINING AN ADVANCE RULING

Obtaining an Advance Ruling:

1. Helps non-residents in planning their income tax affairs well in advance;
2. Brings certainty in determination of the tax liability;
3. Helps in avoiding long drawn litigation; and
4. It is relatively inexpensive, expeditious and binding.

GENERAL ANTI-AVOIDANCE RULES (GAAR)

GAAR is an anti avoidance measure which empowers tax authorities to call a business arrangement or a transaction 'impermissible avoidance arrangement' and thereby denying tax benefits to the parties. Avoidance is legal provision which allows investors to legally reduce their tax liability. GAAR is a concept which generally empowers the Revenue Authorities in a country to deny the tax benefits of transactions or arrangements which do not have any commercial substance or consideration other than achieving the tax benefit. Whenever revenue authorities question such transactions, there is a conflict with the tax payers. Thus, different countries started making rules so that tax cannot be avoided by such transactions. Australia introduced such rules way back in 1981. Later on countries like Germany, France, Canada, New Zealand, South Africa etc too opted for GAAR.

Note: Chapter X-A of the Income Tax Act relating to GAAR is OMITTED.

GAAR IN INDIA

In India, the real discussions on GAAR came to light with the release of draft Direct Taxes Code Bill (popularly known as DTC 2009) on 12th August 2009. It contained the provisions for GAAR. Later on the revised Discussion Paper was released in June 2010, followed by tabling in the Parliament on 30th August, 2010, a formal Bill to enact the law known as the Direct Taxes Code 2010.

Concept of avoidance has been an area of debate and Supreme Court in the latest Vodafone judgment has held it to be valid provided it is allowed by the law and also opining that India has room to enact GAAR. Introduction of GAAR was announced in the Finance Act 2012. And the first draft of GAAR when published received heavy criticism and thereby Shome committee was formed to come up with recommendations and guidelines. The instant paper discusses ramification of GAAR into two parts. First part discusses the ramifications of first draft of GAAR in a general manner without going into detail and second part discusses the ramifications of recommendations given by the Shome committee. The introduction of GAAR is inevitable but it has to be reasonable to facilitate conducive investment environment. As per the final recommendations of expert committee on GAAR, GAAR needs to be deferred for 3 years upto A.Y 2016-17

Many provisions of GAAR have been criticised by various people. However, the basic criticism of GAAR provisions is that it is considered to be too sweeping in nature and there was a fear (considering poor record of IT authorities in India) that Assessing Officers will apply these provisions in a routine manner (or read misuse) and harass the general honest tax payer too. There is only a fine distinction between Tax Avoidance and Tax Mitigation, as any arrangement to obtain a tax benefit can be considered as an impermissible avoidance arrangement by the assessing officer. Thus, there was a hue and cry to put checks and balances in place to avoid arbitrary application of the provisions by the assessing authorities. It was felt that there is a need for further legislative and administrative safeguards and at least a minimum threshold limit for invoking GAAR should be introduced so that small time tax payers are not harassed.

GAAR versus SAAR

In addition to GAAR there also exists SAAR- Specific Anti-Avoidance Rules which specifically aim at certain arrangements of tax avoidance. SAAR have many points to its favour, since its specific there is no scope of confusion, it doesn't provide taxation authorities any discretion and from the point of view of tax payer it provides certainty regarding the nature of his arrangement. Provisions of SAAR are there in Chapter X of the Income Tax Act 1961 and some of the provisions pertaining to SAAR are in various other chapters of Income Tax Act.

LESSON ROUND UP

- The concept of advance rulings under the Act was introduced by the Finance Act, 1993, Chapter XIX-B of the Act, which deals with advance rulings, came into force with effect from 1.6.1993. Under the scheme, the power of giving advance rulings has been entrusted to an independent adjudicatory body designated, as Authority for Advance Rulings (AAR).
- **Who can seek advance ruling:** As per Section 245N(b) of the Income Tax Act, the advance ruling under the income-tax act could be sought by :
 - A non-resident;
 - Resident having transactions with non-residents.
 - Specified categories of residents.
- **Application for advance ruling:** An applicant shall make an application in such form and in such manner as may be prescribed, stating the question on which the advance ruling is sought. The application shall be made in quadruplicate and be accompanied by a fee of two thousand five hundred rupees.
- **Powers of authority:** Section 245U deals with the Powers of the Authority. Sub-section (1) provides that for the purpose of exercising its powers, the Authority shall have all the powers of a Civil Court under the Code of Civil Procedure, 1908 (5 of 1908) as are referred to in Section 131 of the Income-tax Act.
- **Applicability of advance ruling :** The advance ruling pronounced by the Authority under Section 245R shall be binding only :
 - On the applicant who had sought it;
 - In respect of the transactions in relation to which the ruling had been sought; and
 - On the Commissioner, and the income-tax authorities subordinate to him, in respect of the applicant and the said transaction.”
- GAAR is an anti avoidance measure which empowers tax authorities to call a business arrangement or a transaction 'impermissible avoidance arrangement' and thereby denying tax benefits to the parties.

SELF TEST QUESTIONS

These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation.

ELABORATIVE

1. What is the procedure for making an application for obtaining advance rulings under section 245Q of the Income-tax Act, 1961?
2. Explain the provisions relating to 'advance ruling' in the Income-tax Act, 1961. Who can seek 'advance rulings'?
3. Explain the powers of the Authority for Advance Rulings in regard to rejection of an application and modification of an order.

PRACTICAL QUESTIONS

1. Can a public sector undertaking which has undertaken a transaction with a non-resident, seek an advance ruling in respect of tax liability of the non-resident and also its own liability ? Indicate the scope of applicability of such advance rulings.

2. Can a resident assessee claim that the advance ruling obtained by his brother in respect of a similar issue faced by him is applicable to him also ? Will such a ruling be binding on him also ?
 3. Whether tax is required to be deducted from commission paid to an agent outside India, if no services are performed in India or there is no fixed place of business in India ? Explain and comment in the light of recent judgement of Authority for Advance Rulings (AAR).

SUGGESTED READINGS

1. Dr. V.K. Singhania : Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.
 2. Girish Ahuja and Ravi Gupta : Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.
 3. Dr. V.K. Singhania & Dr. Kapil Singhania : Professional Approach to Direct Taxes Law & Practice; Bharat Law House, New Delhi.
 3. Dr. V.K. Singhania & Dr. Kapil Singhania : Direct Taxes Law & Practice; Taxmann Publications Pvt. Ltd., New Delhi.

PART B

SERVICE TAX & SALES TAX

LESSONS

17.	Background, Administration and Procedural Aspects of Service Tax
18.	Levy, Collection and Payment of Service Tax
19.	Introduction, Computation and Other Procedural Aspects of VAT and CST
20.	VAT Provisions in India and VAT System in other Countries and Scope for Company Secretaries

LEARNING OBJECTIVES

Second part of the study will cover the Service Tax and Value Added Tax (VAT) including Central Sales Tax (CST). Service Tax and VAT are the forms of indirect tax imposed on specified services called "taxable services" and sale of goods within the state and Inter-state called VAT and CST respectively.

Service Tax was first brought into force with effect from 1 July 1994. All service providers in India, except those in the state of Jammu and Kashmir, are required to pay a Service Tax in India. Initially only three services were brought under the net of service tax and the tax rate was 5%. Gradually more services came under the ambit of Service Tax and from 1st of July 2012 onwards service tax is charged on all services excepts covered under negative list of services and mega exemption list of services.

VAT is a multi-stage tax levied at each stage of the value addition chain, with a provision to allow input tax credit (ITC) on tax paid at an earlier stage, which can be appropriated against the VAT liability on subsequent sale. With the introduction VAT, state sales tax was replaced with VAT however, CST is still in place which will be phased out in coming times or as when the GST will come into place.

To keep pace with all these changes, one has to be very alert and updated. In order to comply with the dynamic subject of tax laws, industry requires the services of tax professionals like Company Secretaries. After going through the lessons of Service Tax and VAT, students will acquire practical and procedural knowledge of Service Tax, VAT and CST Laws.

Lesson 17

Background, Administration and Procedural Aspects of Service Tax

LESSON OUTLINE

- Background
- Constitutional validity
- Limbs of service tax laws
- Administrative mechanism
- Taxability of services
 - Meaning of service
 - Declared services
 - Negative list of services
 - List of exemptions under mega notification
 - Place of provision of services rules
- Computation of service tax
- Lesson round up
- Self Test Questions

LEARNING OBJECTIVES

The Service tax was introduced on the recommendation of Dr. Raja Chelliah Committee on tax reforms. Initially it was imposed at a uniform rate of 5% in the Union Budget for 1994-95 on 3 services. In a journey of about 19 years, it has seen various changes. Finance Act, 2012 has made remarkable changes in service tax legislation whereby the concept of Positive list of Taxable services has been replaced with a negative list. There is paradigm shift in the way services are taxed. Now all services except as notified in Negative list or exemption list are subject to applicability of service tax.

At the end of this lesson, you will learn

- The principles underlying the introduction of service tax
- Constitutional background of service tax
- Administrative machinery of service tax
- Components which provides for governance of service tax law
- Place of Provision of Services Rules
- Applicable rate of service tax.

Service tax is administered by the Central Board of Excise and Customs (CBEC) which is under the control of the Department of Revenue, Ministry of Finance. CBEC administers the service tax through the Central Excise Department. A separate cell called the service tax cell, under each Commissionrates of central excise has been created for the purpose. Considering large number of assessees, CBEC has also established Service Tax Commissionrates in some cities.

BACKGROUND

As the economy grows and develops, the contribution of the services sector becomes more substantial. Hence, tax on services becomes substantial revenue for the Government. Although Service tax is a concept of the modern era where developed economies as well as developing economies find over 70% of their gross economic output coming from the service sector. Service tax was there in vogue even in the Mauryan period in India. Ms. Romila Thapar in her "Asoka and the Decline of the Mauryas", at page 72 (London 196, paperback edition, 1997, by Oxford) points out that services of weapon and implement makers were required to be provided to the state for a certain number of days in a year. This was a form of service tax in that period. But in the modern context, because of the increasing contribution of the service sector to the GDP of an economy, the importance of service tax is growing. As under the WTO agreements governments are required to reduce customs tariffs, governments are considering increase in service taxes revenues as a compensatory revenue generation mechanism. In terms of economics, tax on services is an indirect tax. This is because the burden of service tax can be passed on to the customer i.e., the recipient of the service. The service provider may also bear the burden of the tax by not passing or charging the same to a customer.

Example: How the burden of service tax shifted on the consumer?

Mr. Mohit is practicing Company Secretary, he represent before the Tax Authorities on behalf of Mr. Neeraj and raise a invoice of ₹1,00,000 plus service tax @12.36%.

Here, Mr. Neeraj is the client and he is required to pay the service tax of ₹12,360 in addition to the value of services. Subsequently Mr. Mohit deposit the sum to treasury of Central Government.

The ultimate outcome of this is that the burden of service tax is on the consumer.

The Tax Reforms Committee headed by Dr. Raja J Chelliah recognized the revenue potential of the service sector and recommended imposition of service tax on selected services (selective approach or positive list approach). Consequently the service tax was imposed at a uniform rate of 5% in the Union Budget for 1994-95 on 3 services.

Finance Act, 2012 has made remarkable changes in service tax legislation whereby the concept of Positive list of Taxable services has been replaced with a negative list. A negative list of services implies that there is, a list of services which are not be subject to service tax. Service tax will not be chargeable on the services mentioned in the negative list and which are exempted by issue of notification. This is in contrast to the earlier method of taxation of services where the law had provided definition for each taxable service and all other undefined services were outside the preview of Service Tax.

Reason for Imposition of Service Tax

In *ALL INDIA FEDN. OF TAX PRACTITIONERS v. UNION OF INDIA* 2007 (7) S.T.R. 625 (S.C.) the Hon'ble Supreme Court of India has mentioned the following reasons for the imposition of service tax.

Service tax is an indirect tax levied on certain services provided by certain categories of persons including companies, association, firms, body of individuals etc. Service sector contributes about 64% to the GDP. Services" constitute heterogeneous spectrum of economic activities. Today services cover wide range of activities such as management, banking, insurance, hospitality, consultancy, communication, administration, entertainment, research and development activities forming part of retailing sector. Service sector is today occupying the centre stage of the Indian economy. It has become an Industry by itself. In the contemporary world, development of service sector has become synonymous with the advancement of the economy. Economics hold the view that there is no distinction between the consumption of goods and consumption of services as both satisfy the human needs.

In late seventies, Government of India initiated an exercise to explore alternative revenue sources due to resource constraints. The primary sources of revenue are direct and indirect taxes. Central excise duty is a tax on the goods produced in India whereas customs duty is the tax on imports. The word "goods" has to be understood in contradistinction to the word "services". Customs and excise duty constitute two major sources of indirect taxes in India. Both are consumption specific in the sense that they do not constitute a charge on the business but on the client. However, by 1994, Government of India found revenue receipts from customs and excise on the decline due to W.T.O. commitments and due to rationalization of duties on commodities. Therefore, in the year 1994-95, the then Union Finance Minister introduced the new concept of "service tax" by imposing tax on services of telephones, non-life insurance and stock-brokers. That list has increased since then. Knowledge economy has made "services" an important revenue-earner.

At this stage, we may refer to the concept of "Value Added Tax" (VAT), which is a general tax that applies, in principle, to all commercial activities involving production of goods and provision of services. VAT is a consumption tax as it is borne by the consumer.

In the light of what is stated above, it is clear that Service Tax is a VAT which in turn is destination based consumption tax in the sense that it is on commercial activities and is not a charge on the business but on the consumer and it would, logically, be leviable only on services provided within the country. Service tax is a value added tax.

As stated above, service tax is VAT. Just as excise duty is a tax on value addition on goods, service tax is on value addition by rendition of services. Therefore, for our understanding, broadly "services" fall into two categories, namely, property based services and performance based services. Property based services cover service providers such as architects, interior designers, real estate agents, construction services, mandap Keepear etc.. Performance based services are services provided by service providers like stock-brokers, practicing company secretaries, practicing chartered accountants, practicing cost accountants, security agencies, tour operators, event managers, travel agents etc.

Government of India in order to tap new areas of taxation and to identify the hidden one appointed Tax Reforms Committee under the Chairmanship of Dr.Raja J Chelliah in August, 1991. The recommendations made by the Committee were accepted and the Service Tax was introduced in the Budget for 1994-95 through the Finance Act, 1994. Under the said enactment, Service Tax is the tax on notified services provided or to be provided. After its introduction, the constitutional validity of the services taxed by the Central Government was challenged before the Constitution Bench of this Court which took the view that the Central Government derived its authority from Entry 97 of List I of the Seventh Schedule to the Constitution for levying tax on services provided.

CONSTITUTIONAL VALIDITY

As per Article 246 of the Constitution of India, law can be enacted by Parliament or the State legislature, if such power is given by the Constitution of India.

Article 265 of the Constitution lays down that no tax shall be levied or collected except by the authority of law.

Schedule VII divides this subject into three categories –

- (a) Union list (only Central Government has power of legislation)
- (b) State list (only State Government has power of legislation)
- (c) Concurrent list (both Central and State Government can pass legislation).

Entry 97 of the Union list is the residuary entry and empowers the Central Government to levy tax on any matter not enumerated in state list or the concurrent list.

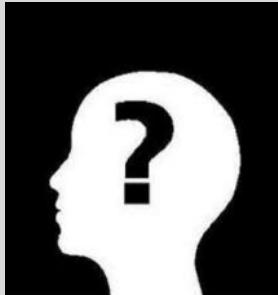
In 1994, the service tax was levied by the central government under the power granted by the entry 97 of the union list.

Thereafter in 2003 the government has passed the constitution (88th Amendment Act, 2003) which provides for

the levy of service tax by the centre through the insertion of article 268A to the constitution. In addition to article 268A, entry 92C has been inserted in the union list to make the enactment relating to service tax a subject matter of union list.

Students may note that entry No.92C has not yet been made effective by the parliament and service tax is still governed by the entry 97 of the union list.

TEST YOUR KNOWLEDGE

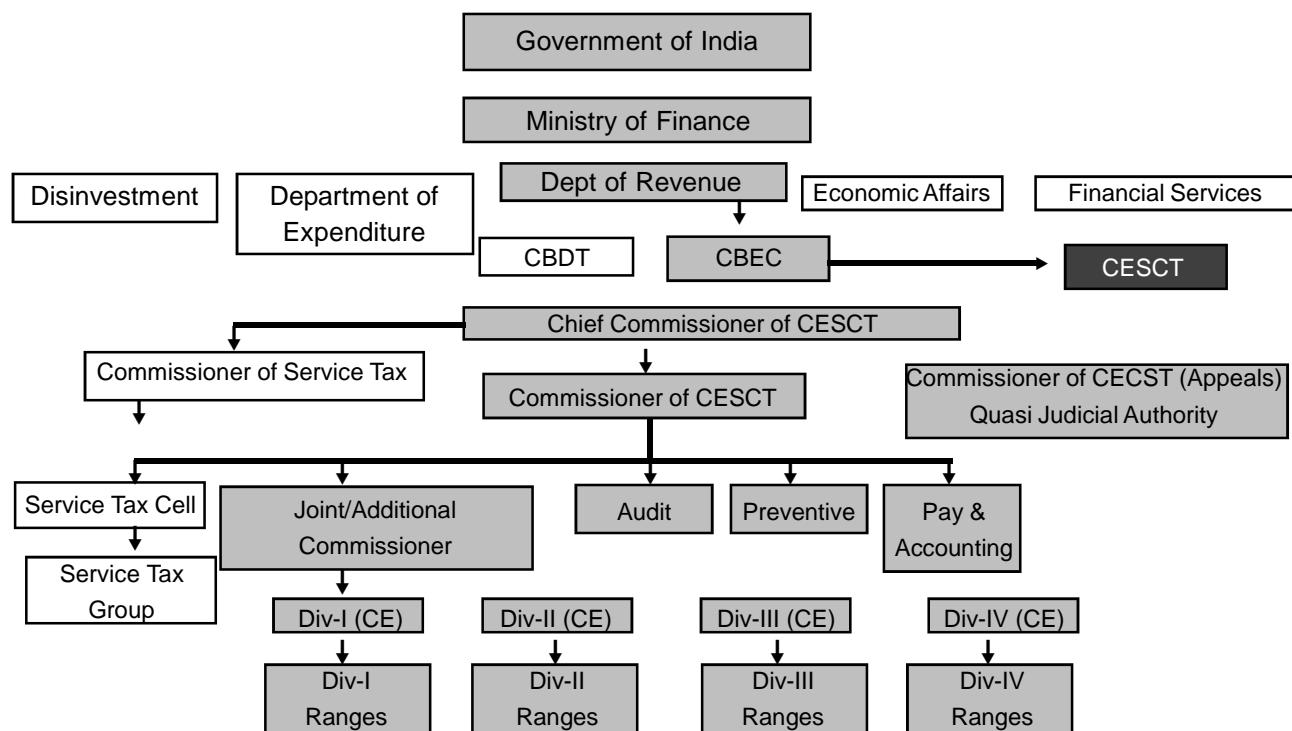


1. When service tax was first introduced in the year 1994, it was levied on a uniform basis.
- True
 - False

ADMINISTRATIVE MECHANISM

Service tax is administered by the Central Board of Excise and Customs (CBEC) which is under the control of the Department of Revenue, Ministry of Finance. CBEC administers the service tax through the Central Excise Department. A Central Excise Commissionate establishes a separate cell called the service tax cell for the purpose of administration of Service Tax within its jurisdiction. Considering large number of assessees, CBEC has also established Service Tax Commissionates in some cities. There are six Commissionates located at metropolitan cities of Delhi, Mumbai, Kolkata, Chennai, Ahmadabad and Bangalore which deal exclusively with work related to Service Tax. These Commissionates are supervised by the jurisdictional Chief Commissionate of Central Excise.

ADMINISTRATIVE STRUCTURE – SERVICE TAX



Division in charge : Assistant/Deputy Commissioner

Range in Charge: Superintendent

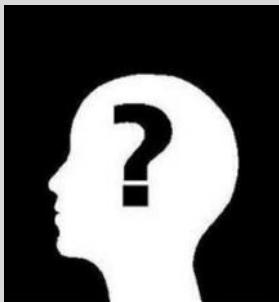
NOTES:

CESTAT	=	Custom Excise Service Tax Appellate Tribunal
CECST	=	Central Excise, Customs & Service Tax
Div	=	Division

When separate Service Tax Commissioner is Constituted, then Commissioner of CECST, Commissioner of CEC, Service Tax Cell Comes under Service Tax Commissioner.

When separate Service Tax Commissioner is not Constituted, then Service Tax Cell Comes under Commissioner of CECST.

The above Chart is illustrative, as under the Commissioner of CECST or Commissioner of CEC there are other functional departments like Adjudication, Refunds, Technical Cell, Laboratory, Establishment.

TEST YOUR KNOWLEDGE

2. Service Tax is administered by
- CBEC
 - CBDT
 - Central Government
 - None of the above

TAXABILITY OF SERVICES

Service Tax is levied vide Finance Act, 1994 (the Act). The Finance Act, 1994 applies all over India except the state of Jammu & Kashmir.

With effect from 1st July 2012, a new charging Section 66B has been inserted by the Finance Act 2012. Section 66B provides that there shall be levied a tax (hereinafter referred to as the service tax) at the rate of twelve per cent on the value of all services, other than those services specified in the negative list, provided or agreed to be provided in the taxable territory by one person to another and collected in such manner as may be prescribed.

The taxation of services is completely overhauled from positive approach or selective services to negative list approach. Now, no classification of services is required for the purpose of taxability. Moreover, only services rendered in taxable territory are taxable for which Place of Provision of Service Rules, 2012 ('PPSR') are prescribed and with this Import of Services and Export of Services Rules has been rescinded.

LIMBS OF SERVICE TAX LAWS

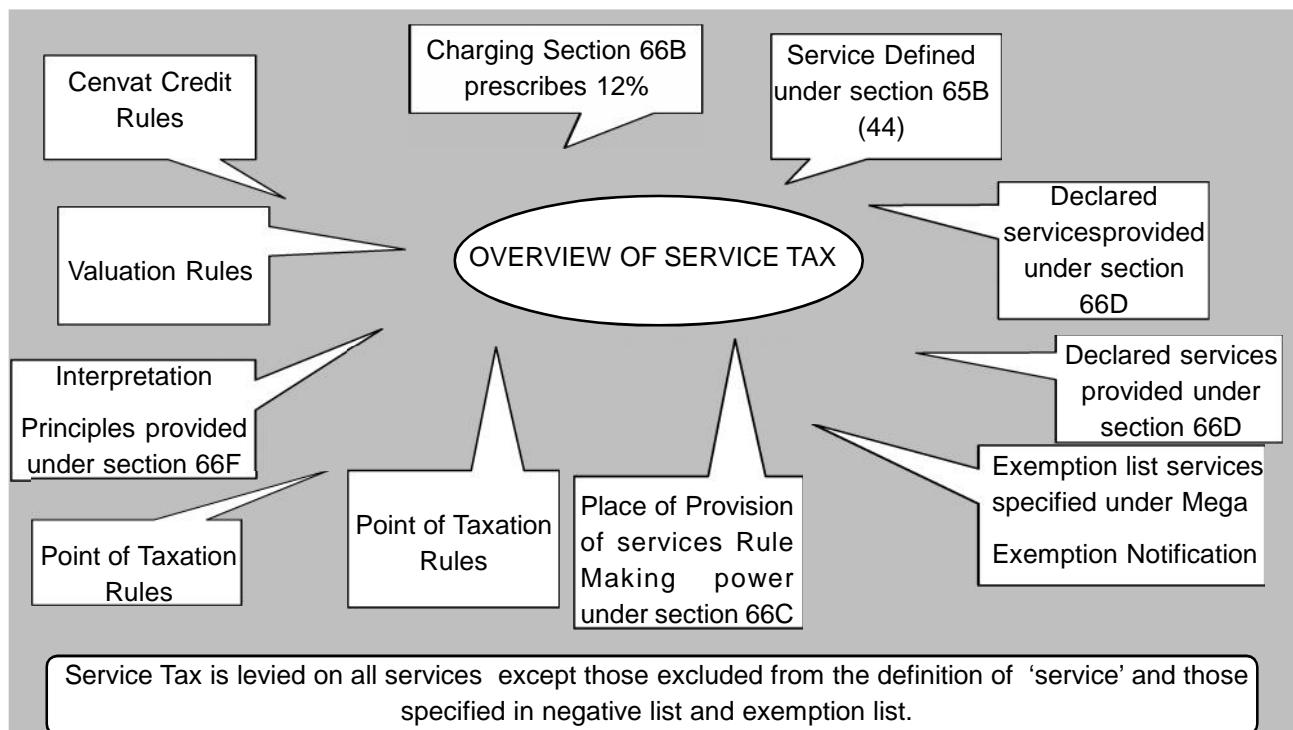
The various limbs of the Service Tax Law are:

- Chapter V and VA (SECTIONS 64 TO 98) of the Finance Act, 1994 as amended by successive Finance Acts;
- As per Section 83 of the Finance Act, 1994 the provisions of the following sections of the Central Excise Act, 1944, as in force from time to time, shall apply, so far as may be, in relation to service tax as they apply in relation to a duty of excise :- sub-section 2 of 9A, 9AA, 9B, 9C, 9D, 9E, 11B, 11BB, 11C, 12, 12A, 12B, 12C, 12D, 12E, 14, 15, 31, 32, 32A to 32P, 33A, 35EE, 34A, 35F, 35FF, to 35O (both inclusive),

35Q, 35R, 36, 36A, 36B, 37A, 37B, 37C, 37D 38A and 40. Certain Sections of Central Excise Act, 1944 are also made applicable to the Service Tax matters.

- Service Tax Rules, 1994;
- Service Tax (Advance Ruling), Rules 2003;
- The CENVAT Credit Rules, 2004;
- Service Tax (Advance Rulings) Rules, 2003
- Authority for Advance Rulings (Central Excise, Customs and Service Tax) Procedure Regulations, 2005;
- Service Tax (Registration of Special category of persons) Rules, 2005;
- Service Tax (Determination of Value) Rules, 2006;
- Service Tax (Provisional Attachment of Property) Rules, 2008;
- Service Tax (Publication of Names) Rules, 2008;
- Service Tax Return Preparer Scheme, 2009;
- Point of Taxation Rules, 2011;
- Indirect Tax Ombudsman Guidelines, 2011;
- Service Tax (Settlement of Cases) Rules, 2012;
- Service Tax (Compounding of Offences) Rules, 2012;
- Service Tax (Removal of Difficulty) Order, 2012;
- Place of Provision of Services Rules, 2012.

Further, Service Tax Notifications issued by the Government is also an important limb of Service Tax law. The Central Board of Excise and Customs also issues Circulars on service tax and on the basis of Circulars jurisdictional Commissionerates of Central Excise issues Trade Notices for the guidance of the assessees on service tax matters.



MEANING OF SERVICE

The Finance Act, 2012 has also defined a term “Service” for the first time. In other words, from June 1994 to June 2012, the Finance Act, 1994 was not containing a definition of the term Service.

Clause (44) of Section 65B of the Act has defined a term Service as under:

“Service” means any activity carried out by a person for another for consideration, and includes a declared service, but shall not include—

- (a) an activity which constitutes merely,—
 - (i) a transfer of title in goods or immovable property, by way of sale, gift or in any other manner; or
 - (ii) such transfer, delivery or supply of any goods which is deemed to be a sale within the meaning of clause (29A) of Article 366 of the Constitution; or
 - (iii) a transaction in money or actionable claim;
- (b) a provision of service by an employee to the employer in the course of or in relation to his employment;
- (c) fees taken in any Court or tribunal established under any law for the time being in force.

Explanation 1 – For the removal of doubts, it is hereby declared that nothing contained in this clause shall apply to—

- (A) the functions performed by the Members of Parliament, Members of State Legislative, Members of Panchayats, Members of Municipalities and Members of other local authorities who receive any consideration in performing the functions of that office as such member; or
- (B) the duties performed by any person who holds any post in pursuance of the provisions of the Constitution in that capacity; or
- (C) the duties performed by any person as a Chairperson or a Member or a Director in a body established by the Central Government or State Governments or local authority and who is not deemed as an employee before the commencement of this section.

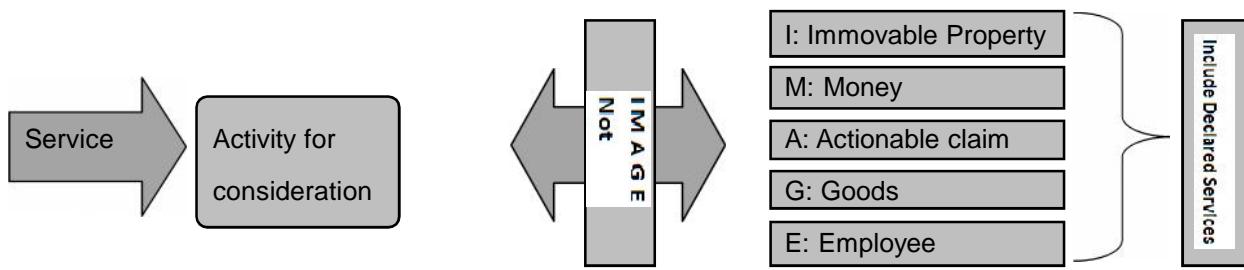
Explanation 2– For the purposes of this clause, transaction in money shall not include any activity relating to the use of money or its conversion by cash or by any other mode, from one form, currency or denomination to another form, currency or denomination for which a separate consideration is charged.

Explanation 3– For the purposes of this Chapter,—

- (a) an unincorporated association or a body of persons, as the case may be, and a member thereof shall be treated as distinct persons;
- (b) an establishment of a person in the taxable territory and any of his other establishment in a non taxable territory shall be treated as establishments of distinct persons.

Explanation 4– A person carrying on a business through a branch or agency or representational office in any territory shall be treated as having an establishment in that territory;

Example: Service of an unincorporated body or a non-profit entity registered under any law for the time being in force to its own members up to an amount of ₹5,000 per member per month by way of reimbursement of charges or share of contribution is exempt from service tax. Where RWA is working as a pure agent of its members for sourcing of goods or services from a third person, amount collected by RWA from its members may be excluded from the value of taxable service in terms of Rule 5(2) of Service Tax (Determination of Value) Rules, 2006 subject to compliance with the specified conditions.



ACCOUNTING CODES FOR SERVICES

Service Tax accounting codes must be mentioned in the Service Tax Payment Challan (GAR 7). In case of Multiple service Provider (a service provider rendering more than one taxable service), amount attributable to each such service along with the concerned accounting codes should be mentioned clearly in the column provided for this purpose in the GAR 7 Challan.

Accounting code for the purpose of payment of service tax under the Negative List approach [“All Taxable Services” – 00441089] was prescribed vide Circular 161/12/2012 dated 6th July, 2012. However, for statistical analysis suggestions were received for restoration of old accounting codes and to provide list of description of services to the taxpayers for obtaining registration. After examining the suggestions old accounting code list has been restored and service specific accounting codes for the purpose of registration and payment of service tax is provided in annexure to the Circular No.165/16/2012 –ST.

Note: To provide an idea about the accounting codes the circular along with annexure containing the accounting codes are given as annexure at the end of this Supplement.

(A) DECLARED SERVICES

Section 66E specify nine activities or transactions which are declared to be covered as ‘service’. Such activities include:–

- (a) renting of immovable property
- (b) construction of a complex.
- (c) temporary transfer or permitting the use or enjoyment of any intellectual property right
- (d) development, design, programming, customisation, adaptation, upgradation, enhancement, implementation of information technology software
- (e) agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act
- (f) transfer of goods by way of hiring, leasing, licensing or in any such manner without transfer of right to use such goods
- (g) activities in relation to delivery of goods on hire purchase or any system of payment by instalments
- (h) service portion in the execution of a works contract
- (i) service portion in an activity wherein goods, being food or any other article of human consumption or any drink (whether or not intoxicating) is supplied in any manner as a part of the activity

Para No. 3.4.1 of Taxation of Services – An education Guide dated 20.06.2012 has given the following test to determine whether an activity is a taxable service:

STEP 1: To determine whether service is being provided by you:

S.NO.	QUESTION	Provide Your Answer
1	Am I doing an activity (including, but not limited to, an activity Specified in section 65E of the Act) for another person?	YES
2	Am I doing such activity for a consideration?	YES
3	Does this activity consist only of transfer of title in goods or immovable property by way of sale, gift or in any other manner?	NO
4	Does this activity constitute only a transfer, delivery or supply of goods which is deemed to be a sale of goods within the meaning of clause (29A) of article 366 of the Constitution?	NO
5	Does this activity consist only of a transaction in money or actionable claim?	NO
6	Is the consideration for the activity in the nature of court fees for a court or a tribunal?	NO
7	Is such an activity in the nature of a service provided by an employee of such person in the course of employment?	NO
8	Is the activity covered in any of the categories specified in Explanation 1 to clause (44) of section 65B of the Act?	NO

If the answer to the above questions is as per the above answers in column 3 of the table above THEN you are providing a service.

STEP 2: To determine whether service provided by you is taxable

If you are providing a 'service' (Step 1) and then pose the following Questions to yourself-

S.NO.	QUESTION	Provide Your Answer
1	Have I provided or have I agreed to provide the service?	Yes
2	Have I provided or have I agreed to provide the service in the taxable territory?	Yes
3	Is this activity entirely covered in any of the services described in the negative list of services contained in section 66D of the Act?	No

If the answer to the above questions is also as per the answers given in column 2 of the table above then you are providing a 'taxable service'.

(B) NEGATIVE LIST OF SERVICES

A Negative List approach to taxation of services has been introduced vide sections 66B, 66C, 66D, 66E and 66F in Chapter V of the Finance Act. The services specified in the 'Negative List' (section 66D) will remain outside the tax net. All other services, except those specifically exempted by the exercise of powers under section 93(1) of the Finance Act, 1994, would thus be chargeable to service tax. Negative list approach to taxation of services is effective from July 1, 2012.

Section 66D specify the following list of services under the negative list: –

- services by Government or a local authority excluding the following services to the extent they are not covered elsewhere –

- (i) services by the Department of Posts by way of speed post, express parcel post, life insurance and agency services provided to a person other than Government.
 - (ii) services in relation to an aircraft or a vessel, inside or outside the precincts of a port or an airport.
 - (iii) transport of goods or passengers.
 - (iv) support services, other than services covered under clauses (i) to (iii) above, provided to business entities.
- (b) services by the Reserve Bank of India.
- (c) services by a foreign diplomatic mission located in India.
- Vide Notification No. 27/2012 dated 20/6/2012, services provided by any person for the official use of a Foreign Diplomatic Mission has been exempted if the prescribed conditions are satisfied.
- (d) services relating to agriculture or agricultural produce by way of–
- (i) agricultural operations directly related to production of any agricultural produce including cultivation, harvesting, threshing, plant protection or testing.
 - (ii) supply of farm labour.
 - (iii) processes carried out at an agricultural farm including tending, pruning, cutting, harvesting, drying, cleaning, trimming, sun drying, fumigating, curing, sorting, grading, cooling or bulk packaging and such like operations which do not alter the essential characteristics of agricultural produce but make it only marketable for the primary market.
 - (iv) renting or leasing of agro machinery or vacant land with or without a structure incidental to its use.
 - (v) loading, unloading, packing, storage or warehousing of agricultural produce.
 - (vi) agricultural extension services.
 - (vii) services by any Agricultural Produce Marketing Committee or Board or services provided by a commission agent for sale or purchase of agricultural produce.
- (e) trading of goods.
- (f) any process amounting to manufacture or production of goods.
- (g) selling of space or time slots for advertisements other than advertisements broadcast by radio or television.
- (h) service by way of access to a road or a bridge on payment of toll charges.
- (i) betting, gambling or lottery.
- (j) admission to entertainment events or access to amusement facilities.
- (k) transmission or distribution of electricity by an electricity transmission or distribution utility.
- (l) services by way of –
- (i) pre-school education and education up to higher secondary school or equivalent.
 - (ii) education as a part of a curriculum for obtaining a qualification recognised by any law for the time being in force.
 - (iii) education as a part of an approved vocational education course.
- (m) services by way of renting of residential dwelling for use as residence.
- (n) services by way of –

- (i) extending deposits, loans or advances in so far as the consideration is represented by way of interest or discount ;
- (ii) inter se sale or purchase of foreign currency amongst banks or authorised dealers of foreign exchange or amongst banks and such dealers.
- (o) service of transportation of passengers, with or without accompanied belongings, by
 - (i) a stage carriage
 - (ii) railways in a class other than –
 - (A) first class or
 - (B) an airconditioned coach
 - (iii) metro, monorail or tramway
 - (iv) inland waterways
 - (v) public transport, other than predominantly for tourism purpose, in a vessel between places located in India and
 - (vi) metered cabs, radio taxis or auto rickshaws
- (p) services by way of transportation of goods–
 - (i) by road except the services of–
 - (A) a goods transportation agency; or
 - (B) a courier agency
 - (ii) by an aircraft or a vessel from a place outside India up to the customs station of clearance in India or
 - (iii) by inland waterways
- (q) funeral, burial, crematorium or mortuary services including transportation of the deceased.

(C) LIST OF EXEMPTIONS UNDER MEGA NOTIFICATION

In exercise of the powers conferred by sub-section (1) of section 93 of the Finance Act, 1994, the Central Government has issued Notification No. 25/ 2012 ST dated 20th June 2012 (Mega Exemption Notification) exempting the following taxable services. This notification has come in to effect from 1st day of July, 2012.

1. Services provided to the United Nations or a specified international organization.

“Specified international organization” means an international organization declared by the Central Government in pursuance of section 3 of the United Nations (Privileges and Immunities) Act, 1947 (46 of 1947), to which the provisions of the Schedule to the said Act apply;

The illustrative list of such organizations has been provided by Para No.7.1, Taxation of Services – An Education Guide dated 20.06.2012 as follows:

- International Civil Aviation Organisation
- World Health Organisation
- International Labour Organisation
- Food and Agriculture Organisation of the United Nations
- UN Educational, Scientific and Cultural Organisation (UNESCO)

- *International Monetary Fund (IMF)*
- *International Bank for Reconstruction and Development*
- *Universal Postal Union*
- *International Telecommunication Union*
- *World Meteorological Organisation*
- *Permanent Central Opium Board*
- *International Hydrographic Bureau*
- *Commissioner for Indus Waters, Government of Pakistan and his advisers and assistants*
- *Asian African Legal Consultative Committee*
- *Commonwealth Asia Pacific Youth Development Centre, Chandigarh*
- *Delegation of Commission of European Community*
- *Customs Co-operation Council*
- *Asia Pacific Telecommunity*
- *International Centre of Public Enterprises in Developing Countries, Ljubljana (Yugoslavia)*
- *International Centre for Genetic Engineering and Biotechnology*
- *Asian Development Bank*
- *South Asian Association for Regional Co-operation*
- *International Jute Organisation, Dhaka, Bangladesh*

2. Health care services by a clinical establishment, an authorized medical practitioner or para-medics.

The terms health care services are defined as follows:

“Health care services” means any service by way of diagnosis or treatment or care for illness, injury, deformity, abnormality or pregnancy in any recognised system of medicines in India and includes

- services by way of transportation of the patient to and from a clinical establishment, but does not include:
- hair transplant or cosmetic or plastic surgery, except when undertaken to restore or to reconstruct anatomy or functions of body affected due to congenital defects, developmental abnormalities, injury or trauma;

As per para 7.2.1 of Taxation of services –An Education Guide the services provided in recognized systems of medicines in India are exempt. In terms of the Clause (h) of section 2 of the Clinical Establishments Act, 2010, the following systems of medicines are recognized systems of medicines:

- *Allopathy*
- *Yoga*
- *Naturopathy*
- *Ayurveda*
- *Homeopathy*
- *Siddha*
- *Unani*
- *Any other system of medicine that may be recognized by central government*

“clinical establishment” means a hospital, nursing home, clinic, sanatorium or any other institution by, whatever name called, that offers services or facilities requiring diagnosis or treatment or care for illness, injury, deformity, abnormality or pregnancy in any recognised system of medicines in India, or a place established as an independent entity or a part of an establishment to carry out diagnostic or investigative services of diseases;

“authorised medical practitioner” means a medical practitioner registered with any of the councils of the recognised system of medicines established or recognized by law in India and includes a medical professional having the requisite qualification to practice in any recognised system of medicines in India as per any law for the time being in force;

Para 7.2.2. of Taxation of services- An Education Guide describes Paramedics are trained health care professionals, for example nursing staff, physiotherapists, technicians, lab assistants etc. Services by them in a clinical establishment would be in the capacity of employee and not provided in independent capacity and will thus be considered as services by such clinical establishment. Similar services in independent capacity are also exempted.

In short, the health care services provided by a clinical establishment, an authorized medical practitioner and paramedics shall be exempt.

2A. Services provided by cord blood banks by way of preservation of stem cells or any other service in relation to such preservation.

3. Services by a veterinary clinic in relation to health care of animals or birds.

4. Services by an entity registered under section 12AA of the Income tax Act, 1961 (43 of 1961) by way of charitable activities.

“Charitable activities” means activities relating to -

(i) *public health by way of -*

(a) *care or counseling of (i) terminally ill persons or persons with severe physical or mental disability, (ii) persons afflicted with HIV or AIDS, or (iii) persons addicted to a dependence-forming substance such as narcotics drugs or alcohol; or*

(b) *public awareness of preventive health, family planning or prevention of HIV infection;*

(ii) *advancement of religion or spirituality;*

(iii) *advancement of educational programmes or skill development relating to,-*

(a) *abandoned, orphaned or homeless children;*

(b) *physically or mentally abused and traumatized persons;*

(c) *prisoners; or*

(d) *persons over the age of 65 years residing in a rural area;*

(iv) *preservation of environment including watershed, forests and wildlife;*

5. Services by a person by way of-

(a) *renting of precincts of a religious place meant for general public; or*

(b) *conduct of any religious ceremony.*

In this case the exemption is provided to the activity of letting out on rent of areas surrounding, or in the compound of a religious place.

For this purpose, the following are defined as;

“Religious place” means a place which is primarily meant for conduct of prayers or worship pertaining to a religion, meditation, or spirituality;

"General public" means the body of people at large sufficiently defined by some common quality of public or impersonal nature;

6. Services provided by-

(a) an arbitral tribunal to -

- (i) any person other than a business entity; or
- (ii) a business entity with a turnover up to rupees ten lakh in the preceding financial year.

Arbitral tribunal defines as "arbitral tribunal" has the meaning assigned to it in clause (d) of section 2 of the Arbitration and Conciliation Act, 1996 (26 of 1996);

The definition as provided in clause (d) of section 2 of the Arbitration and Conciliation Act, 1996 read as; "arbitral tribunal" means a sole arbitrator or a panel of arbitrators"

Further, Business entity is defined in section 65B of the Finance Act, 1994 as 'any person ordinarily carrying out any activity relating to industry, commerce or any other business.

Thus, services provided by arbitral tribunal to a business entity having turnover of more than ₹ 10 lakhs in the preceding financial year would not be exempt.

(b) an individual as an advocate or a partnership firm of advocates by way of legal services to,-

- (i) an advocate or partnership firm of advocates providing legal services ;
- (ii) any person other than a business entity; or
- (iii) a business entity with a turnover up to rupees ten lakh in the preceding financial year; or

"Advocate" has the meaning assigned to it in clause (a) of sub-section (1) of section 2 of the Advocates Act, 1961 (25 of 1961);

The definition of advocate has been defined in clause (a) of subsection (1) of section 2 of the Advocates Act, 1961 as; "advocate means an advocate entered in any roll under the provisions of this Act"

"legal service" means any service provided in relation to advice, consultancy or assistance in any branch of law, in any manner and includes representational services before any court, tribunal or authority;

Thus, any services provided by such advocates/firms in fields other than legal services would be taxable. Such services can include services relating to mergers and acquisitions, due diligence etc.

(c) a person represented on an arbitral tribunal to an arbitral tribunal.

7. Services by way of technical testing or analysis of newly developed drugs, including vaccines and herbal remedies, on human participants by a clinical research organisation approved to conduct clinical trials by the Drug Controller General of India.

In order to promote development of new drugs, exemption is provided to testing and analysis of such new drugs.

8. Services by way of training or coaching in recreational activities relating to arts, culture or sports.

Vide Circular No. 164/15/2012 S.T, dated 28-08-2012, it has been clarified that no service tax is leviable on vocational education/training/skill development courses (VEC) offered by the Government (Central Government or state Government) or local authority themselves. Also in case of such courses offered by an entity independently established by the Government under the law as a society or any other similar body, it has been clarified that the words "recognised by an entity established under a central or state law including delegated legislation, for the purpose of granting recognition to any education course including a VEC

9. Services provided to an educational institution in respect of education exempted from service tax, by way of,-

- (a) auxiliary educational services; or
- (b) renting of immovable property.

Here, exemption is provided to

- to an educational institution
- in respect of education
- which is exempt from levy of service tax
- by way of auxiliary educational services
- by way of renting of immovable property.

For this purpose 'auxiliary educational services' are defined as follows:

"auxiliary educational services" means any services relating to imparting any skill, knowledge, education or development of course content or any other knowledge – enhancement activity, whether for the students or the faculty, or any other services which educational institutions ordinarily carry out themselves but may obtain as outsourced services from any other person, including services relating to admission to such institution, conduct of examination, catering for the students under any mid-day meals scheme sponsored by Government, or transportation of students, faculty or staff of such institution;

9A. Any services provided by, –

- (i) the National Skill Development Corporation set up by the Government of India;
- (ii) a Sector Skill Council approved by the National Skill Development Corporation;
- (iii) an assessment agency approved by the Sector Skill Council or the National Skill Development Corporation;
- (iv) a training partner approved by the National Skill Development Corporation or the Sector Skill Council in relation to (a) the National Skill Development Programme implemented by the National Skill Development Corporation; or (b) a vocational skill development course under the National Skill Certification and Monetary Reward Scheme; or (c) any other Scheme implemented by the National Skill Development Corporation.

10. Services provided to a recognised sports body by-

- (a) an individual as a player, referee, umpire, coach or team manager for participation in a sporting event organized by a recognized sports body;
- (b) another recognised sports body.

For this purpose 'Recognized sports body' is defined as follows:

"Recognized sports body" means - (i) the Indian Olympic Association, (ii) Sports Authority of India, (iii) a national sports federation recognised by the Ministry of Sports and Youth Affairs of the Central Government, and its affiliate federations, (iv) national sports promotion organisations recognised by the Ministry of Sports and Youth Affairs of the Central Government, (v) the International Olympic Association or a federation recognised by the International Olympic Association or (vi) a federation or a body which regulates a sport at international level and its affiliated federations or bodies regulating a sport in India;

11. Services by way of sponsorship of sporting events organised,-

- (a) by a national sports federation, or its affiliated federations, where the participating teams or individuals represent any district, state, zone or country;
- (b) by Association of Indian Universities, Inter-University Sports Board, School Games Federation of India, All India Sports Council for the Deaf, Paralympic Committee of India or Special Olympics Bharat;
- (c) by Central Civil Services Cultural and Sports Board;
- (d) as part of national games, by Indian Olympic Association; or
- (e) under Panchayat Yuva Kreeda Aur Khel Abhiyaan (PYKKA) Scheme.

12. Services provided to the Government, a local authority or a governmental authority by way of construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, or alteration of-

- (a) a civil structure or any other original works meant predominantly for use other than for commerce, industry, or any other business or profession;
- (b) a historical monument, archaeological site or remains of national importance, archaeological excavation, or antiquity specified under the Ancient Monuments and Archaeological Sites and Remains Act, 1958 (24 of 1958);
- (c) a structure meant predominantly for use as (i) an educational, (ii) a clinical, or (iii) an art or cultural establishment;
- (d) canal, dam or other irrigation works;
- (e) pipeline, conduit or plant for (i) water supply (ii) water treatment, or (iii) sewerage treatment or disposal; or
- (f) a residential complex predominantly meant for self-use or the use of their employees or other persons specified in the Explanation 1 to clause 44 of section 65 B of the said Act.

For this purpose 'governmental authority' is defined as follows:

"governmental authority" means a board, or an authority or any other body established with 90% or more participation by way of equity or control by Government and set up by an Act of the Parliament or a State Legislature to carry out any function entrusted to a municipality under article 243W of the Constitution;

13. Services provided by way of construction, erection, commissioning, installation, completion, fitting out, repair, maintenance, renovation, or alteration of,-

- (a) a road, bridge, tunnel, or terminal for road transportation for use by general public;
- (b) a civil structure or any other original works pertaining to a scheme under Jawaharlal Nehru National Urban Renewal Mission or Rajiv Awaas Yojana;
- (c) a building owned by an entity registered under section 12AA of the Income tax Act, 1961(43 of 1961) and meant predominantly for religious use by general public;
- (d) a pollution control or effluent treatment plant, except located as a part of a factory; or
- (e) a structure meant for funeral, burial or cremation of deceased.

14. Services by way of construction, erection, commissioning, or installation of original works pertaining to,-

- (a) an airport, port or railways, including monorail or metro;
- (b) a single residential unit otherwise than as a part of a residential complex;
- (c) low-cost houses up to a carpet area of 60 square metres per house in a housing project approved by competent authority empowered under the 'Scheme of Affordable Housing in Partnership' framed by the Ministry of Housing and Urban Poverty Alleviation, Government of India;
- (d) post-harvest storage infrastructure for agricultural produce including a cold storages for such purposes; or
- (e) mechanised food grain handling system, machinery or equipment for units processing agricultural produce as food stuff excluding alcoholic beverages.

"Original works" means has the meaning assigned to it in Rule 2A of the Service Tax (Determination of Value) Rules, 2006;

Definition as provided in such rules is as follows:

Original works means:

- (i) All new constructions;

(ii) All types of additions and alterations to abandoned or damaged structures on land that are required to make them workable;

(iii) Erection, commissioning or installation of plant, machinery or equipment or structures, whether pre-fabricated or otherwise.

"residential complex" means any complex comprising of a building or buildings, having more than one single residential unit;

"single residential unit" means a self-contained residential unit which is designed for use, wholly or principally, for residential purposes for one family;

15. Services provided by way of temporary transfer or permitting the use or enjoyment of a copyright,-

- (a) covered under clause (a) of sub-section (1) of section 13 of the Copyright Act, 1957 (14 of 1957), relating to original literary, dramatic, musical or artistic works; or
- (b) of cinematograph films for exhibition in a cinema hall or cinema theatre.

16. Services by a performing artist in folk or classical art forms of (i) music, or (ii) dance, or (iii) theatre, excluding services provided by such artist as a brand ambassador.

17. Services by way of collecting or providing news by an independent journalist, Press Trust of India or United News of India.

18. Services by way of renting of a hotel, guest house, club, campsite or other commercial places meant for residential or lodging purposes, having declared tariff of a unit of accommodation below rupees one thousand per day or equivalent.

"Declared tariff" includes charges for all amenities provided in the unit of accommodation (given on rent for stay) like furniture, air-conditioner, refrigerators or any other amenities, but without excluding any discount offered on the published charges for such unit;

19. Services provided in relation to serving of food or beverages by a restaurant, eating joint or a mess, other than those having the facility of air-conditioning or central air-heating in any part of the establishment, at any time during the year.

19A. Services provided in relation to serving of food or beverages by a canteen maintained in a factory covered under the Factories Act, 1948 (63 of 1948), having the facility of air-conditioning or central air-heating at any time during the year.

20. Services by way of transportation by rail or a vessel from one place in India to another of the following goods -

- (a) Omitted by Finance Act, 2013 as enacted on 10th May 2013;
- (b) relief materials meant for victims of natural or man-made disasters, calamities, accidents or mishap;
- (c) defence or military equipments;
- (d) omitted;
- (e) omitted;
- (f) newspaper or magazines registered with the Registrar of Newspapers;
- (g) railway equipments or materials;
- (h) agricultural produce;
- (i) foodstuff including flours, tea, coffee, jaggery, sugar, milk products, salt and edible oil, excluding alcoholic beverages; or
- (j) chemical fertilizer and oilcakes.

21. Services provided by a goods transport agency, by way of transport in a goods carriage of,-

- (a) agricultural produce;
- (b) goods, where gross amount charged for the transportation of goods on a consignment transported in a single carriage does not exceed one thousand five hundred rupees;
- (c) goods, where gross amount charged for transportation of all such goods for a single consignee does not exceed rupees seven hundred fifty;
- (d) foodstuff including flours, tea, coffee, jaggery, sugar, milk products, salt and edible oil, excluding alcoholic beverages;
- (e) chemical fertilizer and oilcakes;
- (f) newspaper or magazines registered with the Registrar of Newspapers;
- (g) relief materials meant for victims of natural or man-made disasters, calamities, accidents or mishap; or
- (h) defence or military equipments;

“Goods carriage” has the meaning assigned to it in clause (14) of section 2 of the Motor Vehicles Act, 1988 (59 of 1988);

22. Services by way of giving on hire -

- (a) to a state transport undertaking, a motor vehicle meant to carry more than twelve passengers; or
- (b) to a goods transport agency, a means of transportation of goods.

“State transport undertaking” has the meaning assigned to it in clause (42) of section 2 of the Motor Vehicles Act, 1988 (59 of 1988);

For clarification, Taxation of services –An Education Guide dated 20.06.2012, provides the following:

7.11.5 Is giving of a bus on hire to any person liable to tax?

Giving on hire a bus to a state transport undertaking is exempt from service tax. If the bus is given on hire to a person other than a state transport undertaking, it will be taxed.

23. Transport of passengers, with or without accompanied belongings, by -

- (a) air, embarking from or terminating in an airport located in the state of Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, or Tripura or at Bagdogra located in West Bengal;
- (b) a contract carriage for the transportation of passengers, excluding tourism, conducted tour, charter or hire; or
- (c) ropeway, cable car or aerial tramway.

“contract carriage” has the meaning assigned to it in clause (7) of section 2 of the Motor Vehicles Act, 1988 (59 of 1988);

24. Omitted;

25. Services provided to Government, a local authority or a governmental authority by way of -

- (a) carrying out any activity in relation to any function ordinarily entrusted to a municipality in relation to water supply, public health, sanitation conservancy, solid waste management or slum improvement and upgradation; or
- (b) repair or maintenance of a vessel.

26. Services of general insurance business provided under following schemes-

- (a) Hut Insurance Scheme;
- (b) Cattle Insurance under Swarnajayanti Gram Swarozgar Yojna (earlier known as Integrated Rural Development Programme);

- (c) Scheme for Insurance of Tribals;
- (d) Janata Personal Accident Policy and Gramin Accident Policy;
- (e) Group Personal Accident Policy for Self-Employed Women;
- (f) Agricultural Pumpset and Failed Well Insurance;
- (g) premia collected on export credit insurance;
- (h) Weather Based Crop Insurance Scheme or the Modified National Agricultural Insurance Scheme, approved by the Government of India and implemented by the Ministry of Agriculture;
- (i) Jan Arogya Bima Policy;
- (j) National Agricultural Insurance Scheme (Rashtriya Krishi Bima Yojana);
- (k) Pilot Scheme on Seed Crop Insurance;
- (l) Central Sector Scheme on Cattle Insurance;
- (m) Universal Health Insurance Scheme;
- (n) Rashtriya Swasthya Bima Yojana; or
- (o) Coconut Palm Insurance Scheme.

26A. Services of life insurance business provided under the following schemes—

- (a) Janashree Bima Yojana (JBY); or
- (b) Aam Aadmi Bima Yojana (AABY);

27. Services provided by an **incubatee** up to a total turnover of fifty lakh rupees in a financial year subject to the following conditions, namely:-

- (a) the total turnover had not exceeded fifty lakh rupees during the preceding financial year; and
- (b) a period of three years has not been elapsed from the date of entering into an agreement as an incubatee.

“incubatee” means an entrepreneur located within the premises of a Technology Business Incubator (TBI) or Science and Technology Entrepreneurship Park (STEP) recognised by the National Science and Technology Entrepreneurship Development Board (NSTEDB) of the Department of Science and Technology, Government of India and who has entered into an agreement with the TBI or the STEP to enable himself to develop and produce hi-tech and innovative products;

28. Service by an unincorporated body or a non- profit entity registered under any law for the time being in force, to its own members by way of reimbursement of charges or share of contribution -

- (a) as a trade union;
- (b) for the provision of carrying out any activity which is exempt from the levy of service tax; or
- (c) up to an amount of five thousand rupees per month per member for sourcing of goods or services from a third person for the common use of its members in a housing society or a residential complex;

“trade union” has the meaning assigned to it in clause (h) of section 2 of the Trade Unions Act, 1926 (16 of 1926).

For clarification Taxation of services – An Education Guide dated 20.06.2012, provides the following:

7.11.9 I am a Resident Welfare Association (RWA). The members contribute an amount to RWA for holding camps to provide health care services to poor men and women. Am I required to pay tax on contribution received from members?

No. You are not required to pay service tax on the contribution received as you are carrying out any activity (holding camps to provide health care services) which is exempt from the levy of service tax. If contribution is for carrying out an activity which is taxable, you are required to pay service tax.

29. Services by the following persons in respective capacities -

- (a) sub-broker or an authorised person to a stock broker;
- (b) authorised person to a member of a commodity exchange;
- (c) mutual fund agent to a mutual fund or asset management company;
- (d) distributor to a mutual fund or asset management company;
- (e) selling or marketing agent of lottery tickets to a distributor or a selling agent;
- (f) selling agent or a distributor of SIM cards or recharge coupon vouchers;
- (g) business facilitator or a business correspondent to a banking company or an insurance company, in a rural area; or
- (h) sub-contractor providing services by way of works contract to another contractor providing works contract services which are exempt;

“sub-broker” has the meaning assigned to it in sub-clause (gc) of clause 2 of the Securities and Exchange Board of India (Stock Brokers and Sub-brokers) Regulations, 1992;

“authorised person” means any person who is appointed as such either by a stock broker (including trading member) or by a member of a commodity exchange and who provides access to trading platform of a stock exchange or a commodity exchange as an agent of such stock broker or member of a commodity exchange;

“commodity exchange” means an association as defined in section 2(j) and recognized under section 6 of the Forward Contracts (Regulation) Act, 1952 (74 of 1952);

“distributor or selling agent” has the meaning assigned to them in clause (c) of the rule 2 of the Lottery (Regulation) Rules, 2010 notified by the Government of India in the Ministry of Home Affairs, published in the Gazette of India, Extraordinary, Part-II, Section 3, Sub-section (i), vide number G.S.R. 278(E), dated the 1st April, 2010 and shall include distributor or selling agent authorised by the lottery-organising State;

“business facilitator or business correspondent” means an intermediary appointed under the business facilitator model or the business correspondent model by a banking company or an insurance company under the guidelines issued by Reserve Bank of India;

“banking company” has the meaning assigned to it in clause (a) of section 45A of the Reserve Bank of India Act, 1934(2 of 1934);

“general insurance business” has the meaning assigned to it in clause (g) of section 3 of General Insurance Business (Nationalisation) Act, 1972 (57 of 1972);

“insurance company” means a company carrying on life insurance business or general insurance business;

“life insurance business” has the meaning assigned to it in clause (11) of section 2 of the Insurance Act, 1938 (4 of 1938);

“rural area” means the area comprised in a village as defined in land revenue records, excluding-

the area under any municipal committee, municipal corporation, town area committee, cantonment board or notified area committee; or any area that may be notified as an urban area by the Central Government or a State Government;

For clarification Taxation of services – An Education Guide dated 20.06.2012, provides the following:

2.8.12 Would recharge vouchers issued by service companies for enabling clients/consumers to avail services like mobile phone communication, satellite TV broadcasts, DTH broadcasts etc be ‘actionable claims’?

No. Such recharge vouchers do not create a 'beneficial interest' in a moveable property but only enable a person to enjoy a particular service.

7.11.11 Whether the exemption provided in the mega -exemption to services by way of construction of roads, airports, railways, transport terminals, bridges, tunnels, dams etc., is also available to the sub-contractors who provide input service to these main contractors in relation to such construction?

As per clause (1) of section 66F reference to a service by nature or description in the Act will not include reference to a service used for providing such service. Therefore, if any person is providing services, in respect of projects involving construction of roads, airports, railways, transport terminals, bridges, tunnels, dams etc., such as architect service, consulting engineer service which are used by the contractor in relation to such construction, the benefit of the specified entries in the mega-exemption would not be available to such persons unless the activities carried out by the sub-contractor independently and by itself falls in the ambit of the exemption.

It has to be appreciated that the wordings used in the exemption are 'services by way of construction of roads etc' and not 'services in relation to construction of roads etc'. It is thus apparent that just because the main contractor is providing the service by way of construction of roads, airports, railways, transport terminals, bridges, tunnels, dams etc., it would not automatically lead to the classification of services being provided by the sub-contractor to the contractor as an exempt service.

However, a sub-contractor providing services by way of works contract to the main contractor, providing exempt works contract services, has been exempted from service tax under the mega exemption if the main contractor is engaged in providing exempt services of works contracts. It may be noted that the exemption is available to sub-contractors engaged in works contracts and not to other outsourced services such as architect or consultants.

30. Carrying out an intermediate production process as job work in relation to -

- (a) agriculture, printing or textile processing;
- (b) cut and polished diamonds and gemstones; or plain and studded jewellery of gold and other precious metals, falling under Chapter 71 of the Central Excise Tariff Act ,1985 (5 of 1986);
- (c) any goods on which appropriate duty is payable by the principal manufacturer; or
- (d) processes of electroplating, zinc plating, anodizing, heat treatment, powder coating, painting including spray painting or auto black, during the course of manufacture of parts of cycles or sewing machines upto an aggregate value of taxable service of the specified processes of one hundred and fifty lakh rupees in a financial year subject to the condition that such aggregate value had not exceeded one hundred and fifty lakh rupees during the preceding financial year;

"Appropriate duty" means duty payable on manufacture or production under a Central Act or a State Act, but shall not include 'Nil' rate of duty or duty wholly exempt;

"Principal manufacturer" means any person who gets goods manufactured or processed on his account from another person;

31. Services by an organiser to any person in respect of a business exhibition held outside India;

For clarification Taxation of services – An Education Guide dated 20.06.2012, provides the following:

Para No. 7.11.16 Footwear Association of India is organizing a business exhibition in Germany for footwear manufacturers of India. Is Footwear association of India required to pay service tax on services to footwear manufacturers?

No. The activity is exempt from service tax.

32. Services by way of making telephone calls from –

- (a) departmentally run public telephone;
- (b) guaranteed public telephone operating only for local calls; or
- (c) free telephone at airport and hospital where no bills are being issued.

For clarification Taxation of services –An Education Guide dated 20.06.2012, provides the following:

Para No. 7.11.13 Whether service tax is leviable on telephone services rendered by M/s. BSNL through Village Panchayat Telephone (VPT) with local call facility, as M/s. BSNL is a public sector unit and telephones run by it cannot be treated as 'departmentally run telephones'?

As per Sl. No. 32 of the mega-exemption Notification in addition to exemption to 'departmentally run telephones' there is exemption for 'Guaranteed Public Telephone operating only for local calls' also. Village Public Telephones (VPTs) with facility of local calls (without 9 dialing facility or STD facility) run by BSNL would fall under the category of 'Guaranteed Public Telephone operating only for local calls'.

33. Services by way of slaughtering of animals.

34. Services received from a provider of service located in a non-taxable territory by -

- (a) Government, a local authority, a governmental authority or an individual in relation to any purpose other than commerce, industry or any other business or profession;
- (b) an entity registered under section 12AA of the Income tax Act, 1961 (43 of 1961) for the purposes of providing charitable activities; or
- (c) a person located in a non-taxable territory.

For clarification Taxation of services –An Education Guide dated 20.06.2012, provides the following example:

Para No. 7.11.17 I am resident in Jammu and Kashmir and planning to construct a property in Delhi. I have got the architectural drawings made from an architect who is also resident in Jammu and Kashmir. Am I liable to pay service tax on architect services?

Solution: No. Even though the property is located in Delhi- in a taxable territory- your architect is exempt from service tax as both the service provider and the service receiver is in a non-taxable territory.

35. Services of public libraries by way of lending of books, publications or any other knowledge- enhancing content or material.

36. Services by Employees' State Insurance Corporation to persons governed under the Employees' Insurance Act, 1948 (34 of 1948).

37. Services by way of transfer of a going concern, as a whole or an independent part thereof.

As per Taxation of services –An Education Guide dated 20.06.2012, 'transfer of going concern' means transfer of a running business which is capable of being carried on by the purchaser as an independent business, but shall not cover mere or predominant transfer of an activity comprising a service. Such sale of business as a whole will comprise comprehensive sale of immovable property, goods and transfer of unexecuted orders, employees, goodwill etc. Since the transfer in title is not merely a transfer in title of either the immovable property or goods or even both it may amount to service and has thus been exempted.

38. Services by way of public conveniences such as provision of facilities of bathroom, washrooms, lavatories, urinal or toilets.

39. Services by a governmental authority by way of any activity in relation to any function entrusted to a municipality under article 243W of the Constitution.

40. Services by way of loading, unloading, packing, storage or warehousing of rice.

"governmental authority" means an authority or a board or any other body;

(i) set up by an Act of Parliament or a State Legislature; or

(ii) established by government, with 90% or more participation by way of equity or control, to carry out any function entrusted to a municipality under article 243W of the Constitution;

(D) PLACE OF PROVISION OF SERVICES RULES

Service Tax Is Destination Consumption Based Tax

Service Tax is a Value Added Tax (VAT) and is destination based consumption tax in the sense that it is on commercial activities and is not a charge on the business but on the consumer and it would, logically, be leviable only on services provided within the country. This principle is more or less universally applied.

In terms of this principle, exports are not charged to tax, as the consumption is outside the taxable territory, and services are taxed on their importation into the taxable territory.

However, most of the services are intangible in nature; the determination of place of their consumption is not easy. Services could be provided by a person located at one location, actually performed at another while being delivered to a person located at a third location, and occasionally actually consumed at a third location or over a larger geographical territory, falling in more than one taxable jurisdiction. For example a person situated in Delhi may buy a ticket on line from a service provider located outside India, say Delta Airline, USA for a journey from Mumbai to New York, wherein part of the service will be provided on Indian land mass or in taxable territory (the territory of India including territorial waters of India extending up to 12 nautical miles (under International Sea Act). Hence services provided beyond the territorial waters of India are not liable to service tax as the provisions of the service tax have not been extended beyond India). On other occasions the exact location of service recipient itself may not be available e.g. services supplied electronically through internet such as software services, web based services, software maintenance services. As a result it is necessary to lay down rules determining the exact place of provision, while ensuring a certain level of harmonization with international practices in order to avoid both the double taxation as well as double non-taxation of services.

It is also a common practice to largely tax services provided by business to other business entities, based on the location of the customers and other services from business to consumers based on the location of the service provider. Since the determination in terms of above principle is not easy, or sometimes not practicable, nearest proxies are adopted to provide specificity in the interpretation as well as application of the law.

Function of Place of Provision of Services Rules, 2012

These rules are primarily meant for:

- (a) The assessee who deal in cross-border services (from taxable territory to non taxable territory or from non taxable territory to taxable territory).
- (b) Those assessees who have operations with suppliers or customers in the state of Jammu and Kashmir.
- (c) Service providers operating within India (within the taxable territory) from multiple locations, without having centralized registration will find them useful in determining the precise taxable jurisdiction applicable to their operations.
- (d) Determining services that are wholly consumed within a SEZ, to avail the outright exemption from service tax.

Basic Framework

Place of Provision of Services (POPS) Rules, 2012 are comprehensive set of rules which provides for whether a service has been provided in taxable territory or not. The concept of Export or Import service has been replaced with provision of service in taxable or non taxable territory and therefore no separate set of rules for Export and Import of services exists. The rules for determination of import of services has done away with and export of services are now determined with Rule 6A of Service Tax Rules, 1994.

How the POPS Rules, 2012 shall apply

The answer to this question is provided in Para 5.2.1. of **Taxation of Services – An Education Guide** dated 20.06.2012 as follows:

As stated earlier, in terms of section 66B, a service is taxable only when, *inter alia*, it is “provided (or agreed to be provided) in the taxable territory”. Thus, the taxability of a service will be determined based on the place of its provision. For determining the taxability of a service, therefore, one needs to ask the following questions sequentially:-

1. Which rule applies to the service provided specifically? In case more than one rules apply equally, which of these come later in the order given in the rules?
2. What is the place of provision of the service in terms of the above rule?
3. Is the place of provision in taxable territory? If yes, tax will be payable. If not, tax will not be payable.
4. Is the provider ‘located’ in the taxable territory? If yes, he will pay the tax.
5. If not, is the service receiver located in taxable territory? If yes, he may be liable to pay tax on reverse charge basis.
6. Is the service receiver an individual or government receiving services for a non business purpose, or a charity receiving services for a charitable activity? If yes, the same is exempted. If not, he is liable to pay tax.

Before moving to the Rules for determining the Place of provision of Services Rules, the understanding of the following term is very important.

Taxable territory has been defined in sub-section 52 of section 65B. It means the territory to which the provisions of Chapter V of the Finance Act, 1994 apply i.e. whole of India excluding the state of Jammu and Kashmir.

“Non-taxable territory” is defined in sub-section 35 *ibid* accordingly as the territory other than the taxable territory.

“**India**” is defined in sub-section 27 of section 65 B, as follows:

“India” means—

- (a) the territory of the Union of India as referred to in clauses (2) and (3) of article 1 of the Constitution;
- (b) its territorial waters, continental shelf, exclusive economic zone or any other maritime zone as defined in the Territorial Waters, Continental Shelf, Exclusive Economic Zone and Other Maritime Zones Act, 1976;
- (c) the sea-bed and the subsoil underlying the territorial waters;
- (d) the air space above its territory and territorial waters; and
- (e) the installations structures and vessels located in the continental shelf of India and the exclusive economic zone of India, for the purposes of prospecting or extraction or production of mineral oil and natural gas and supply thereof;

Order of Application of POPS, Rules 2012

Rule 14 of POPS rules, provides that rules should be interpreted in reverse order, means rules which comes last in order will be considered first and if that is not applicable then go to the second last and so on. These rules should be applied in the reverse order (from below to above) i.e. in case rule 8 is applicable no other rule prior to this rule shall be applicable.

An illustration is given in Para 5.14.1 of Taxation of Services – An Education Guide dated 20.06.2012 as follows:

Illustration

An architect based in Mumbai provides his service to an Indian Hotel Chain (which has business establishment in New Delhi) for its newly acquired property in Dubai. If Rule 5 (Property rule) were to be applied, the place of provision would be the location of the property i.e. Dubai (outside the taxable territory). With this result, the service would not be taxable in India. Whereas, by application of Rule 8, since both the provider and the receiver are located in taxable territory, the place of provision would be the location of the service receiver i.e. New Delhi. Place of provision being in the taxable territory, the service would be taxable in India.

By application of Rule 14, the later of the Rules i.e. Rule 8 would be applied to determine the place of provision.

Illustration

For the Miss Universe Contest planned to be held in South Africa, the Indian pageant (say, located in Mumbai) avails the services of Indian beauticians, fashion designers, videographers, and photographers. The service providers travel as part of the Indian pageant's entourage to South Africa. Some of these services are in the nature of personalized services, for which the place of provision would normally be the location where performed (Performance rule-Rule 4), while for others, under the main rule (Receiver location) the place of provision would be the location of receiver.

Whereas, by application of Rule 8, since both the provider and the receiver are located in taxable territory, the place of provision would be the location of the service receiver i.e. New Delhi. Place of provision being in the taxable territory, the service would be taxable in India.

By application of Rule 14, the later of the Rules i.e. Rule 8 would be applied to determine the place of provision.

Main Rule: Rule 3

Rule 3 of the POPS rules provide the basic rule (expect provided otherwise in the POPS Rules). As per this rule, the place of provision of services shall be:

- the location of the recipient of service
- in case the location of the service receiver is not available in the ordinary course of business, the place of provision shall be the location of the provider of service.

The principal effect of this rule is that:-

- A. *Where the location of receiver of a service is in the taxable territory, such service will be deemed to be provided in the taxable territory and service tax will be payable.*
- B. *However if the receiver is located outside the taxable territory, no service tax will be payable on the said service.*

Rule 2 defines 'location of service provider' as follows:

- (h) "location of the service provider" means-
 - (a) where the service provider has obtained a single registration, whether centralized or otherwise, the premises for which such registration has been obtained;
 - (b) where the service provider is not covered under sub-clause (a):
 - (i) *the location of his business establishment; or*
 - (ii) *where the services are provided from a place other than the business establishment, that is to say, a fixed establishment elsewhere, the location of such establishment; or*

- (iii) where services are provided from more than one establishment, whether business or
- (iv) *fixed, the establishment most directly concerned with the provision of the service; and in the absence of such places, the usual place of residence of the service provider.*

Rule 2 defines 'location of service receiver' as follows

- (i) "Location of the service receiver" means:-
 - (a) where the recipient of service has obtained a single registration, whether centralized or otherwise, the premises for which such registration has been obtained;
 - (b) where the recipient of service is not covered under sub-clause (a):
 - (i) the location of his business establishment; or
 - (ii) where services are used at a place other than the business establishment, that is to say, a fixed establishment elsewhere, the location of such establishment; or
 - (iii) where services are used at more than one establishment, whether business or fixed, the establishment most directly concerned with the use of the service; and
 - (iv) in the absence of such places, the usual place of residence of the recipient of service.

Explanation:- For the purposes of clauses (h) and (i), "usual place of residence" in case of a body corporate means the place where it is incorporated or otherwise legally constituted.

Explanation 2:- For the purpose of clause (i), in the case of telecommunication service, the usual place of residence shall be the billing address.

Who is a service receiver?

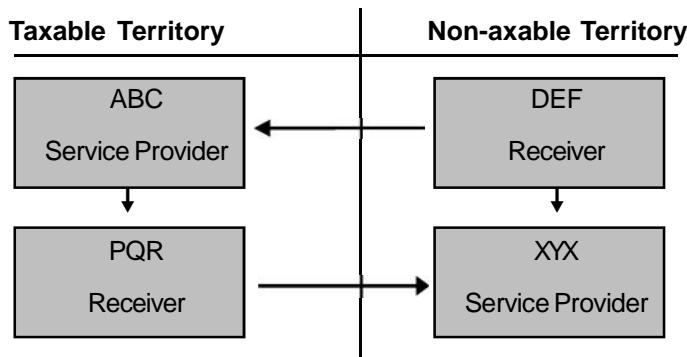
Para 5.3.3 of Taxation of Services – An Education Guide dated 20.06.2012 provides as follows:

Normally, the person who is legally entitled to receive a service and, therefore, obliged to make payment, is the receiver of a service, whether or not he actually makes the payment or someone else makes the payment on his behalf.

Service tax is normally required to be paid by the provider of a service, except where he is located outside the taxable territory and the place of provision of service is in the taxable territory.

Where the provider of a service is located outside the taxable territory, the person liable to pay service tax is the receiver of the service in the taxable territory, unless of course, the service is otherwise exempted.

Following illustration will make this clear:-



A company ABC provides a service to a receiver PQR, both located in the taxable territory. Since the location of the receiver is in the taxable territory, the service is taxable. Service tax liability will be discharged by ABC, being the service provider and being located in taxable territory.

However, if ABC were to supply the same service to a recipient DEF located in non-taxable territory, the provision of such service is not taxable, since the receiver is located outside the taxable territory.

If the same service were to be provided to PQR (located in taxable territory) by an overseas provider XYZ (located in non-taxable territory), the service would be taxable, since the recipient is located in the taxable territory. However, since the service provider is located in a non-taxable territory, the tax liability would be discharged by the receiver, under the reverse charge principle (also referred to as "tax shift").

RATE OF SERVICE TAX

The rate of service tax is mentioned in the charging section. As per the new charging section 66B, as stated earlier, service tax is leviable @12% on the value of taxable services. Further, as per section 91 read with section 95 of the Finance (No. 2) Act, 2004, education cess is leviable @ 2% and as per section 136 read with section 140 of the Finance Act, 2007 secondary and higher education cess is leviable @ 1% of on the amount of Service Tax levied. Education cess of 2% and secondary and higher education cess of 1% is in the nature of tax on service tax.

Computation of Service Tax

If a person renders a taxable service of the value of ₹ 500, the service tax @12% will be ₹ 60. The Education cess of 2% on ₹ 60 will be ₹ 1.20 and secondary and higher education cess of 1% will be ₹ 0.60. Thus, a total tax will be ₹ 61.80.

ROUNDING OFF OF SERVICE TAX

The provisions of Section 37D of the Central Excise Act, 1944 are applicable to Service Tax Law by virtue of Section 83 of Finance Act, 1994 (as amended), provide that the amount of service tax, interest, penalty, fine or any other sum payable and the amount of refund or any other sum due, under the provisions shall be rounded off to the nearest rupee and, for this purpose, where such amount contains a part of a rupee consisting of paise then, if such part is fifty paise or more, it shall be increased to one rupee and if such part is less than fifty paise it shall be ignored.

LESSON ROUND UP

- The Tax Reform Committee headed by Dr. Raja C. Chelliah recognised the revenue potential of service sector and recommended imposition of service tax on some select services.
- Entry No. 92C has not yet been made effective by the parliament and service tax is still governed by the entry 97 of the union list.
- The Central Board of Excise and Customs has been entrusted with the task of administration of service tax.
- The taxation of services is completely overhauled from positive approach or selective services to negative list approach. Now, no classification of services is required for the purpose of taxability.
- With the introduction of Negative list approach the services which are out of the purview of negative list and mega exemption list are chargeable to service tax.
- Services rendered in taxable territory are taxable for which Place of Provision of Service Rules, 2012 ('PPSR') are prescribed and with this Import of services and export of services rules has been rescinded.
- Service tax is charged @12% plus Education cess @2% and SHEC @ 1%.
- Service tax, interest, fine, penalty or any other sum payable shall be rounded off to the nearest of rupee one.

SELF TEST QUESTIONS

These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation.

TRUE AND FALSE

1. Service tax in India is levied under a separate enactment.
2. The Central Excise Officer is empowered to impose penalty under service tax.
3. The Central Government has exempted some of the taxable services.
4. Service tax is administered by service tax department.
5. Service tax has been imposed by amending Chapter-VI of the Finance Act, 1994.
6. Service tax is applicable on whole India excluding Jammu and Kashmir.
7. Rate of service tax payable for the financial year 2012-13 is 10 per cent.

ELABORATIVE

1. Describe briefly the scope of service tax in India.
2. Define the following:
 - (a) Service;
 - (b) Service tax.
3. Describe briefly the mechanism in administering service tax in India.
4. Explain in brief the steps for calculation of service tax under the new regime.

ANSWERS/HINTS

True and False

1. False; 2. True; 3. True; 4. False; 5. False; 6. True; 7. False.

Test Your Knowledge

1. True
2. CBEC

SUGGESTED READINGS

1. Taxation of Services – An Education Guide dated 20.06.2012
2. Service Tax Manual: Taxmann
2. Dr. V.K. Singhania: Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.
3. Girish Ahuja and Ravi Gupta: Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.

Lesson 18

Levy, Collection and Payment of Service Tax

LESSON OUTLINE

- Registration Charge of Service tax
- Service Tax Registration of Special Category of Persons
- Payment of service tax
- Incidence to pay Service Tax
- Point of Taxation Rules, 2011
- Adjustment of Service Tax
- Interest on delayed payment of service tax u/s 75
- Records to be maintained
- E-filing of Service Tax Returns
- Penalties and Prosecution
- Waiver or reduction of penalty
- Abatement in Service Tax
- Role of Company Secretary
- Lesson Round Up
- Self Test Questions

LEARNING OBJECTIVES

This chapter covers the procedural as well substantive provisions relating to levy, collection and payment of service tax and relevant CENVAT Credit Rules 2004. It also covers the registration aspects, filing aspects including e-filing, appeal matters including appeal before Appellate Tribunal. The new regime of service tax i.e. levy of service tax on negative list approach have been discussed in the previous lesson.

At the end of this lesson you will learn :

- What is the basis of charge for service tax?
- What are the circumstances under which service tax is paid by the receiver of services?
- When the liability for payment of service tax arises?
- What is the registration procedure for service provider?
- How to file service tax return?
- What are the Penal provisions for payment/non-payment of service tax?
- What is role of Company Secretaries?

CBEC has rolled-out a new centralized, web-based and workflow-based software application called Automation of Central Excise and Service Tax (ACES) for on-line filing/ uploading of documents and other activities under Central Excise and Service Tax. A Certified Facilitation Centre (CFC) under ACES project is a facility, other than the physical front offices or Facilitation Centres of CBEC, which may be set-up and operated by a Company Secretary in practice to whom a certificate is issued under the ACES project, where the assessees of Central Excise and Service Tax can avail the facility to file their returns and other documents electronically on payment of specified fees.

REGISTRATION

Section 69 of the Finance Act, 1994 specifies the persons who are required to get themselves registered under this Act. Every person liable to pay service tax to get registered with designated Superintendent of Central Excise.

An application for registration is required to be made to the Superintendent of Central Excise in Form ST-1. This is to be made within a period of thirty days from the date on which the service tax is leviable on him and where a person commences the business of providing a taxable service after such service has been levied, he shall make an application for registration within a period of thirty days from the date of such commencement.

As stated earlier, a person can become liable to pay tax both as service provider as well as service receiver. Therefore, when a service receiver is liable to pay service tax he is also required to get himself registered.

Procedure for Registration

With effect from 1st June 2010 vide notification no.20-21/2010 a person shall make an online application for registration. Online registrations have been made mandatory for all the assessees. Assessee has to register via online portal of Automation of Central Excise and Service Tax (ACES) or can utilise the services Certified Facilitation Centres (CFCs) set up by Company Secretaries in practice under the (ACES) project of Central Board of Excise and Custom.

Assessee has to fill Form ST-1 for registration and thereafter submit the following documents as specified in Order No.2/2011 dated 13-12-2011:

- Copy of Permanent Account number (PAN)
- Proof of residence
- Constitution of applicant other than individuals at the time of filing an application for registration.
- Power of attorney in respect of authorized person.

Registration where the services are provided or received from more than one premises and having centralised accounting system in one or more premises:

Where a person, liable for paying service tax on a taxable service

- (i) provides such service from more than one premises or offices; or
- (ii) receives such service in more than one premises or offices; or
- (iii) is having more than one premises or offices, which are engaged in relation to such service in any other manner, making such person liable for paying service tax, and has centralised billing system or centralised accounting system in respect of such service, and such centralised billing or centralised accounting systems are located in one or more premises, he may, at his option, register such premises or offices from where centralised *billing or centralised accounting systems are located*.

The registration under this case shall be granted by the Commissioner of Central Excise in whose jurisdiction the premises or offices, from where centralised billing or accounting is done, are located.

Registration where the services are provided or received from more than one premises and not having centralised accounting system:

Where an assessee is providing a taxable service from more than one premises or offices, and does not have any centralized billing systems or centralized accounting systems, as the case may be, he shall make separate applications for registration in respect of each of such premises or offices to the jurisdictional Superintendent of Central Excise.

Single Registration for Multiple Services

Where an assessee is providing more than one taxable service, he may make a single application, mentioning therein all the taxable services provided by him, to the concerned Superintendent of Central Excise.

Issue of Registration Certificate

The Superintendent of Central excise is bound to grant a certificate of registration in Form ST-2 within 7 days of the date of receipt of the application or intimation for any change or additional information provided by the applicant. This certificate shall indicate the details of all the taxable services provided by the service provider. In case of transfer of business by the assessee to another person, the transferee is required to obtain a fresh Certificate of Registration.

Surrender of Certificate of Registration

The registered assessee who ceases to provide the taxable services for which he had been registered shall surrender his Certificate of Registration to the concerned Superintendent of Central Excise.

Service Tax Registration of Special Category of Persons

Input Service Distributor

Service Tax (Registration of Special Category of Persons) Rules, 2005 have come into effect on 16th day of June, 2005.

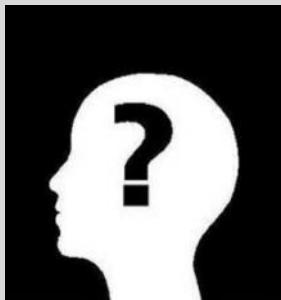
Registration under these rules can be obtained by an input service distributor by making an application to the jurisdictional Superintendent of Central Excise in such form as specified by the Board within a period of thirty days of the commencement of business or the 16th day of June, 2005, whichever is later.

Small Scale Service Provider

A small scale service provider has been specified as any provider of taxable service whose aggregate value of taxable service in a financial year does not exceed a certain specified limit. A small scale service provider whose aggregate value of taxable service in a financial year exceeds nine lakh rupees shall make an application to the jurisdictional Superintendent of Central Excise in the prescribed form for registration within a period of thirty days of exceeding the aggregate value of taxable service of nine lakh rupees.

However, a small scale service provider are not liable to pay service tax till they cross the exemption limit of ₹10 lakhs during a Financial Year.

TEST YOUR KNOWLEDGE



- (1) Any provider of taxable service whose aggregate value of taxable service in a financial year exceeds _____ shall make an application for registration to the jurisdictional Superintendent of Central Excise.
- ₹ 3,00,000
 - ₹ 5,00,000
 - ₹ 7,00,000
 - ₹ 9,00,000

PAYMENT OF SERVICE TAX

As per Section 68(1), every person providing taxable services i.e. provider of taxable service is liable to pay service tax at the rate specified in section 66B of the Finance Act, 1994 in such manner and within such period as may be prescribed.

Section 68(2), provides that in respect of the taxable services notified by the Central Government the service tax thereon shall be paid by such person as may be prescribed. Notification No. 30/2012 dated 20th June 2012 provides for the services where service tax shall be paid by service receiver or in some case by both i.e. service receiver and service provider. The mechanism under which liability for payment of service tax is on the service receiver is known as **reverse charge**. Under this charge service receiver has to register himself under service tax. Further service receiver cannot claim general exemption limit of ₹ 10 Lakhs and he is liable to pay service tax even on small amount.

Below is the list of services covered under Reverse charge mechanism along with the share of service provider and share of service recipient on which they are required to pay service tax.

Sl. No.	Description of a Service	Percentage of service tax payable by the person providing service	Percentage of service tax payable by the person receiving the service
1	Services provided or agreed to be provided by an insurance agent to any person carrying on insurance business	Nil	100%
2	Services provided or agreed to be provided by a goods transport agency in respect of transportation of goods by road	Nil	100%
3	Services provided or agreed to be provided by way of sponsorship	Nil	100%
4	Services provided or agreed to be provided by an arbitral tribunal	Nil	100%
5	Services provided or agreed to be provided by individual advocate or a firm of advocates by way of legal services	Nil	100%
6	Services provided or agreed to be provided by way of support service by Government or local authority excluding renting of immovable property and services specified in section 66D(a) (i), (ii) & (iii)	Nil	100%
7	(a) In respect of services provided or agreed to be provided by way of renting or hiring any motor vehicle designed to carry passenger on abated value to any person who is not in the similar line of business. (b) In respect of services provided or agreed to be provided by way of renting or hiring any motor vehicle designed to carry passenger on non abated value any person who is not in the similar line of business.	Nil 60%	100% 40 %

8.	Services provided or agreed to be provided by way of supply of manpower for any purpose including security services	25%	75 %
9.	Services provided or agreed to be provided by way of works contract	50%	50%
10.	Any taxable services provided or agreed to be provided by any person who is located in a non-taxable territory and received by any person located in the taxable territory	Nil	100%
11.	Services provided or agreed to be provided by a director of a company to the said company	Nil	100%

INCIDENCE TO PAY SERVICE TAX

With effect from 1st July 2011, the liability to pay service tax was shifted from receipt basis to accrual basis with the introduction of Point of Taxation (POT) Rules, 2011. As per rule 3 of POT rules the liability to pay service tax shall arise upon issuance of invoice or receipt of payment whichever is earlier.

Proviso to Rule 6 of Service Tax Rules, 1994 has provided that in case of the individuals and partnership firms having an aggregate value of taxable services provided from one or more premises of ₹ 50 lakhs or less in the previous financial year, shall have the option to pay service tax upon receipt basis upto ₹ 50 lakhs in the current financial year.

The basic purpose for introduction of Point of Taxation Rules, 2011 is to bring clarity and certainty in matter of levy and collection of service tax in situations of:

- Change of rate of service tax
- Imposition of service tax on new services
- Continuous supply of services

Moreover, POT rules, 2011 have been introduced to bring synchronization between service tax and other taxes like Excise Duty and VAT which work on accrual basis and this is a step towards implementation of GST.

POT rules, 2011 were issued by the Central Government vide Notification No. 18/2011- ST dated 1st March, 2011 w.e.f. 1st April 2011. However, these rules were made effective w.e.f. 1st July 2011 vide Notification No.25/ 2011-ST dated 31st March 2011. Now, let us discuss the provisions of these rules:

Point of taxation means the point in time when a service shall be provided or deemed to have been provided. This Point of time will determine rate of service tax and due date of payment of service tax.

As per rule 2A of POT Rules, “Date of payment” shall be the earlier of the dates on which the payment is entered in the books of accounts or is credited to the bank account of the person liable to pay tax:

Provided that —

- (A) the date of payment shall be the date of credit in the bank account when—
 - (i) there is a change in effective rate of tax or when a service is taxed for the first time during the period between such entry in books of accounts and its credit in the bank account; and
 - (ii) the credit in the bank account is after four working days from the date when there is change in effective rate of tax or a service is taxed for the first time; and
 - (iii) the payment is made by way of an instrument which is credited to a bank account,
- (B) if any rule requires determination of the time or date of payment received, the expression “date of payment” shall be construed to mean such date on which the payment is received”.

As per Rule 3 of Point of Taxation Rules, Point of taxation shall be;

- (a) the time when the invoice for service provided or to be provided is issued or
- (b) in case where payment is received before the issue of invoice then the time when such payment is received or
- (c) where advance is received by the service provider the time of receipt of such advance.

Rule 4A of the Service Tax Rules, 1994, provides that every person providing taxable service shall issue invoice within 30 days of completion of service or receipt of payment of service whichever is earlier.

Further proviso to Rule 3 of POT Rules, provides that where the invoice is not issued within 30 days of completion of service than the point of taxation shall the date of completion of such service.

Examples:

Sl. No.	Date of Completion	Date of Invoice	Date on which payment is	Point of taxation	Remarks
1	April 10, 2012	April 20, 2012	April 30, 2012	April 20, 2012	Invoice is issued within 30 days and before payment
2	April 10, 2012	May 26, 2012	April 30, 2012	April 10, 2012	Invoice not issued within 30 days and payment received after completion of service
3	April 10, 2012	April 20, 2012	April 15, 2012	April 15, 2012	Invoice is issued within 30 days and payment received before issue of invoice
4	April 10, 2012	May 26, 2012	April 5, 2012 (Part) and April 25, 2012 (remaining)	April 5, 2012 and April 10, 2012 for remaining	Advance received in part before completion of service and invoice not issued within 30 days of completion of service.

Continuous Supply of Service

“Continuous supply of service” means any service provided or agreed to be provided continuously or on recurrent basis, under a contract, for a period exceeding three months with the obligation for payment periodically or from time to time. Further, Central Government may notify provision of a particular service to be considered as continuous supply of service.

The following services have been notified vide Notification No. 28/2011 as continuous supply of service irrespective of period for which they are provided or to be provided;

- Telecommunication service
- Commercial or Industrial Construction Service
- Construction of Residential Complex
- Internet Communication
- Works contract services

As per Rule 3, in case of continuous supply of service, the point of taxation shall be the date of completion of the events as specified in the contract or time when invoice for the service provided or to be provided is issued or the date on which payment is received whichever is earlier. Where any advance is received by the service provider the point of taxation shall be date of receipt of each such advance. Further, where the invoice is not issued within 30 days of completion of such event then point of taxation shall be the date of completion of such event.

Point of Taxation in case of change in effective rate of tax (Rule 4)

Notwithstanding anything contained in rule 3, the point of taxation in cases where there is a change in effective rate of tax in respect of a service, shall be determined in the following manner, namely:-

- (a) in case a taxable service has been provided before the change in effective rate of tax,-
 - (i) where the invoice for the same has been issued and the payment received after the change in effective rate of tax, the point of taxation shall be date of payment or issuing of invoice, whichever is earlier; or
 - (ii) where the invoice has also been issued prior to change in effective rate of tax but the payment is received after the change in effective rate of tax, the point of taxation shall be the date of issuing of invoice; or
 - (iii) where the payment is also received before the change in effective rate of tax, but the invoice for the same has been issued after the change in effective rate of tax, the point of taxation shall be the date of payment;
- (b) in case a taxable service has been provided after the change in effective rate of tax,-
 - (i) where the payment for the invoice is also made after the change in effective rate of tax but the invoice has been issued prior to the change in effective rate of tax, the point of taxation shall be the date of payment; or
 - (ii) where the invoice has been issued and the payment for the invoice received before the change in effective rate of tax, the point of taxation shall be the date of receipt of payment or date of issuance of invoice, whichever is earlier; or
 - (iii) where the invoice has also been raised after the change in effective rate of tax but the payment has been received before the change in effective rate of tax , the point of taxation shall be date of issuing of invoice.

“Change in effective rate of tax” shall include a change in the portion of value on which tax is payable in terms of a notification issued in the Official Gazette under the provisions of the Act, or rules made thereunder”.

Point of Taxation where Service is Taxed First Time (Rule 5)

Where a service is taxed for the first time, then, –

- (a) no tax shall be payable to the extent the invoice has been issued and the payment received against such invoice before such service became taxable;
- (b) no tax shall be payable if the payment has been received before the service becomes taxable and invoice has been issued within fourteen days of the date when the service is taxed for the first time.

Point of Taxation in case of Specified Services or Persons (Rule 7)

The point of taxation in respect of the persons required to pay tax as recipients of service under the rules made in this regard in respect of services notified under sub-section (2) of section 68 of the Act, shall be the date on which payment is made.

Provided that, where the payment is not made within a period of six months of the date of invoice, the point of taxation shall be determined as if this rule does not exist.

Provided further that in case of “associated enterprises”, where the person providing the service is located outside India, the point of taxation shall be the date of debit in the books of account of the person receiving the service or date of making the payment whichever is earlier.

Determination of Point of Taxation in case of intangibles (Rules 8)

In respect of royalties and payments pertaining to copyrights, trademarks, designs or patents, where the whole amount of the consideration for the provision of service is not ascertainable at the time when service was performed, and subsequently the use or the benefit of these services by a person other than the provider gives rise to any payment of consideration, the service shall be treated as having been provided each time;

- when a payment in respect of such use or the benefit is received by the provider in respect thereof, or
- an invoice is issued by the provider, whichever is earlier.

Determination of Point of Taxation based on best judgement (Rule 8A)

Where the point of taxation cannot be determined as per these rules as the date of invoice or the date of payment or both are not available, the Central Excise officer, may, require the concerned person to produce such accounts, documents or other evidence as he may deem necessary and after taking into account such material and the effective rate of tax prevalent at different points of time, shall, by an order in writing, after giving an opportunity of being heard, determine the point of taxation to the best of his judgment.

DUE DATE FOR PAYMENT OF SERVICE TAX

Rule 6(1) of the Service Tax Rules, 1994 specifies the time period for payment of service tax.

For individuals or proprietors or partnership firms:

The service tax shall be paid to the credit of the Central Government **by the 5th of the month immediately following the respective quarter** in which service is deemed to have been provided as per POT Rules made in this regard.

Where payment is made through internet banking, such e-payment can be made **by 6th of the month immediately following the respective quarter**.

However, for the quarter ending 31st March, the due date of payment of service tax shall be 31st March.

As stated earlier, individuals and partnership firms whose aggregate value of taxable services provided from one or more premises is fifty lakh rupees or less in the previous financial year, the service provider shall have option to pay the service tax on receipt basis by the due dates upto ₹50 lakhs in the current financial year.

For others

The service tax shall be paid to the credit of the Central Government by the 5th of the month immediately following the calendar month in which service is deemed to have been provided.

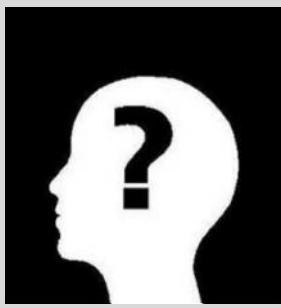
Mandatory e-payment of service tax

Under proviso to Rule 6(2), e-payment of service tax is mandatory for the assessee, who has paid service tax of rupees one lakh (cash plus Cenvat credit) and above in the preceding financial year shall be deposit the service tax liable to be paid by him electronically, through internet banking.

Further, notwithstanding the time of receipt of payment towards the value of services, no service tax is payable for the part or whole of the value of services, which is attributable to services provided during the period when such services were not taxable.

Deposit of Service Tax

The assessee shall deposit the service tax liable to be paid by him with the bank designated by the Central Board of Excise and Customs in Form GAR – 7 challan.

TEST YOUR KNOWLEDGE

- (2) Where payment for service tax is made through internet banking, such e-payment can be made by the _____ of the month, immediately following the quarter in which the payments are received.
- 5th
 - 6th
 - 8th
 - 10th

Interest on Delayed Payment of Service Tax under Section 75

Every person, liable to pay the tax in accordance with the provisions of section 68 or rules made thereunder, who fails to credit the tax or any part thereof to the account of the Central Government within the period prescribed, shall pay simple interest at such rate not below 10% and not exceeding 36% p.a.

However where the service provider whose taxable services does not exceed ₹60 lakhs during any of the financial years covered by the notice or during the last financial year the rate of interest shall be reduced by 3% p.a.

ADJUSTMENT OF SERVICE TAX**(1) Adjustment of excess service tax paid on the services which are not so provided**

Where an assessee has issued an invoice, or received any payment, against a service to be provided which is not so provided by him either wholly or partially for any reason, or where the amount of invoice is renegotiated due to deficient provision of service, or any terms contained in a contract the assessee may take the credit of such excess service tax paid by him, if the assessee,

- has refunded the payment or part thereof, so received along with the service tax payable thereon for the service to be provided by him to the person from whom it was received;
- has issued a credit note for the value of the service tax not so provided to the person to whom such an invoice had been issued.

(2) Adjustment of excess service tax paid in other cases

Where an assessee has paid to the credit of Central Government any amount in excess of the amount required to be paid towards service tax liability for a month or quarter, the assessee may adjust such excess amount paid by him against his service tax liability for the succeeding month or quarter.

The adjustment of excess amount paid, shall be subject to the conditions that the excess amount is paid on account of reasons not involving interpretation of law, taxability, valuation or applicability of any exemption notification.

VALUATION OF TAXABLE SERVICES

Section 67 provides for the method of valuation of taxable services i.e. the value on which service provider is required to discharge service tax. As per section 67, the valuation of taxable service shall be determined under the following two situations:

- Service tax is separately charged in the bill

- Bill value is inclusive of service tax

Where the service tax is separately charged in the bill:

- in a case where the provision of service is for a consideration in money, be the gross amount charged by the service provider for such service provided or to be provided by him;
- in a case where the provision of service is for a consideration not wholly or partly consisting of money, be such amount in money, with the addition of service tax charged, is equivalent to the consideration;
- in a case where the provision of service is for a consideration which is not ascertainable, be the amount as may be determined in the prescribed manner.

Where the bill is inclusive of service tax:

Where the gross amount charged by a service provider, for the service provided or to be provided is inclusive of service tax payable, the value of such taxable service shall be such amount as, with the addition of tax payable, is equal to the gross amount charged. In this case, value of taxable services shall be calculated as follows:

$$\text{Value of taxable Services} = \frac{\text{Gross Amount} \times 100}{100 + \text{Applicable rate of service tax}}$$

Example:

Pawan rendered a taxable service to a client on 25-08-2013. A bill of ₹40,000 was raised on 29-08-2013; ₹15,000 was received from the client on 1-10-2013 and the balance on 23-10-2013.

- If service tax was separately charged in the bill, what is the value of taxable services and service tax payable?
- No Service tax was separately charged in the
 - Is Pawan liable to pay service tax, even though the same has not been charged by him?
 - In case, he is liable, what is the value of taxable services and service tax payable?

Solution

The bill is raised on 29-08-2013 but the payment is received in October 2013. As per Point of Taxation Rules, service tax shall be payable on or before 05-09-2013 or 06-09-2013 and not in October when payment is received.

Therefore, in this case service tax shall be payable as;

- Value of taxable service is ₹ 40,000, therefore service tax shall be payable @ 12% Plus Education @ 2% and SHEC@1%.

$$\text{Service tax} = ₹40,000 \times 12.36\% = ₹ 4944/-$$

- Pawan is liable to pay service tax even though the tax has not been collected by him. The service tax payable shall be;

$$= 40,000 \times 12.36/112.36 = ₹ 4400/-$$

ABATEMENT IN SERVICE TAX

Abatement in Service Tax is a major relief to certain kinds of services which are chargeable to service tax. Finance Act 1994 provides that for determining value of service tax on which service tax is to be charged abatement in value determination is allowed.

Abatement under service tax laws means that for certain services, a specified percentage of discount is allowed from the gross amount collected for rendering the services subject to the conditions that CENVAT Credit has not been availed by the service provider.

Notification No. 26/2012- ST dated 20/06/2012 provides the list of services on which abatement is allowed. It also provides for the percentage on which service tax is payable under the scheme of abatement. The concept of abatement may be understood with the help of this example;

As per notification no. 26/2012, railway is required to charge service tax only on 30% value of the Taxable services. Thereby by virtue of this provision, if railways receive an amount of ₹ 50 Lakhs against the services, it needs to pay service tax only on ₹ 15 Lakhs i.e. 30% value of ₹ 50 Lakhs.

RECORDS TO BE MAINTAINED

Every assessee shall furnish to the Superintendent of Central Excise at the time of filing of return for the first time or the 31st day of January, 2008, whichever is later, a list in duplicate of-

- (i) all the records prepared or maintained by the assessee for accounting of transactions in regard to,-
 - (a) providing of any service,
 - (b) receipt or procurement of input services and payment for such input services;
 - (c) receipt, purchase, manufacture, storage, sale, or delivery, as the case may be, in regard of inputs and capital goods;
 - (d) other activities, such as manufacture and sale of goods, if any.
- (ii) all other financial records maintained by him in the normal course of business;

All such records shall be preserved at least for a period of five years immediately after the financial year to which such records pertain.

The records including computerised data, as maintained by an assessee in accordance with the various laws in force from time to time shall be acceptable.

RETURNS UNDER SERVICE TAX

Rule 7 of the Service Tax Rules, 1994 return under Service Tax is required to be filed by every assessee on half yearly basis in Form ST-3 or Form ST-3A, as the case may be, along with a copy of the Form TR-6/GAR-7, in triplicate for the months covered in the half-yearly return.

Every assessee shall submit the half yearly return by the 25th of the month following the particular half-year. Every assessee is required to file return electronically.

Vide Notification No. 43/2011 dt. 25th August 2011, every Assessee shall submit a half yearly return electronically. Assessee can file service tax return online at registering at <https://www.aces.gov.in>.

With effect from 1st October, 2011, every assessee is required to file half yearly return electronically.

Revision of Returns

As per Rule 7B, an assessee may submit a revised return, in Form ST-3, in triplicate, to correct a mistake or omission, within a period of ninety days from the date of submission of the return under rule 7.

Penalty for not filing and late Filing of Return

If return of service tax is not filed within the prescribed period penalty is leviable under section 77(2) which can be upto ₹10,000.

Rule 7C of Service Tax Rules, 1994 provides for penalty for delay in filing of service tax return. Accordingly late fee is payable as follows:

Delay upto 15 days	₹ 500/-
Delay beyond 15 days and upto 30 days	₹ 1,000/-
Delay beyond 30 days	₹1,000 + ₹ 100/- per day subject to a maximum of ₹ 20,000 [the penalty prescribed in section 70(1)]

Penalty for late filing of return is specifically prescribed in Rule 7C subject to section 70 therefore if late fee is paid then no penalty prescribed under section 77(2) shall be leviable.

PENALTIES AND PROSECUTION

Various penalties have been provided under the Act. Section 83A empowers Central Excise Officer to adjudicate penalty within such powers as may be conferred by CBEC, by issuing a notification.

(A) PENALTY FOR FAILURE TO PAY SERVICE TAX [SECTION 76]

Any person who fails to pay service tax, shall pay, in addition to such tax and the interest on that tax amount in accordance with the provisions of section 75, a penalty which shall not be less than;

- one hundred rupees for every day during which such failure continues; or
- at the rate of one per cent. of such tax, per month, whichever is higher, starting with the first day after the due date till the date of actual payment of the outstanding amount of service tax.

Provided that the total amount of the penalty payable in terms of this section shall not exceed 50% of the service tax payable.

Example

X, an assessee, fails to pay service tax of ₹10 lakhs payable by 5th March. X pays the amount on 15th March. The default has continued for 10 days. The penalty payable by X is computed as follows:-

- 1% of the amount of default for 10 days = $1 \times 10,00,000 \times 10/31 = ₹3,225.80$ or
 - Penalty calculated @ ₹100 per day for 10 days = ₹1,000
- Penalty liable to be paid is ₹ 3,226.00.

(B) PENALTY FOR CONTRAVENTION OF RULES AND PROVISIONS OF ACT FOR WHICH NO PENALTY IS SPECIFIED ELSEWHERE [SECTION 77]

- (a) Any person who is liable to pay service tax, or required to take registration, fails to take registration shall be liable to pay a penalty which may extend to **ten thousand rupees**.
- (b) Any person who fails to keep, maintain or retain books of account and other documents shall be liable to a penalty which may extend to **ten thousand rupees**.
- (c) Any person who fails to —
 - (i) furnish information called by an
 - (ii) produce documents called for by a Central Excise Officer
 - (iii) appear before the Central Excise Officer, when issued with a summon for appearance to give evidence or to produce a document in an inquiry, shall be liable to a penalty which may extend to;
 - ten thousand rupees or

- two hundred rupees for every day during which such failure continues, whichever is higher, starting with the first day after the due date, till the date of actual compliance.
- (d) Any person who is required to pay tax electronically, through internet banking, fails to pay the tax electronically, shall be liable to a penalty which may extend to **ten thousand rupees**.
- (e) Any person who issues invoice with incorrect or incomplete details or fails to account for an invoice in his books of account, shall be liable to a penalty which may extend to **ten thousand rupees**.
- (f) Any person, who contravenes any of the provisions or any rules for which no penalty is separately provided, shall be liable to a penalty which may extend to **Ten thousand rupees**.

(C) PENALTY FOR SUPPRESSING VALUE OF TAXABLE SERVICE [SECTION 78]

Where any service tax has not been levied or paid or has been short-levied or short-paid or erroneously refunded, by reason of

- (a) fraud; or
- (b) collusion; or
- (c) wilful mis-statement; or
- (d) suppression of facts; or
- (e) contravention of any of the provisions or of the rules with intent to evade payment of service tax the person shall be liable to pay service tax or erroneous refund, and

shall be liable to pay a penalty, in addition to such service tax and interest which shall equal to the amount of service tax so not levied or short-paid or erroneously refunded.

However the amount of penalty shall be reduced to:

- (a) 50% where true and complete details of the transactions are available in the specified records.
- (b) 25% where true and complete details of the transactions are available in the specified records and the amount of service tax, interest and penalty has been paid within 30 days.

In case of service providers whose taxable value of service tax does not exceed ₹ 60 lakhs, the period of 30 days shall be extended to 90 days.

Section 78 provides that if penalty is applicable under this section, provisions section 76 shall be apply. Thus, the assessee is relieved from effects of dual penalty.

(D) PENALTY FOR OFFENCES BY DIRECTOR ETC. OF COMPANY [Section 78A]

Where a company has committed any of the following contraventions, namely:—

- (a) evasion of service tax; or
- (b) issuance of invoice, bill or, as the case may be, a challan without provision of taxable service in violation of the rules made under the provisions of this Chapter; or
- (c) availment and utilisation of credit of taxes or duty without actual receipt of taxable service or excisable goods either fully or partially in violation of the rules made under the provisions of this Chapter; or
- (d) failure to pay any amount collected as service tax to the credit of the Central Government beyond a period of six months from the date on which such payment becomes due, then
 - any director, manager, secretary or other officer of such company,

- who at the time of such contravention was in charge of, and was responsible to,
- the company for the conduct of business of such company and was knowingly concerned with such contravention,

shall be liable to a penalty which may extend to one lakh rupees.

WAIVER OR REDUCTION OF PENALTY

As per Section 80, penalty under Sections 76, 77 or first proviso to section 78 (1) can be waived if assessee proves that he had reasonable cause for the failure.

PROSECUTION

Section 89 was inserted by Finance Act, 2011 which provides for offences which can lead to prosecution. The prosecution was introduced in service tax to promote self compliance among the assessee. Further, sections 9A, 9AA, 9B, 9E and 34A of the Central Excise Act, 1944 have been made applicable service tax. These provisions together constitute the provisions relating to prosecution of offences.

CENVAT CREDIT RULES, 2004

The CENVAT Credit Rules, 2004 have replaced the existing Cenvat Credit Rules, 2002 and Service tax Credit Rules, 2002 with effect from 10th September 2004. The new Rules integrated services with goods. With the introduction of these rules, inter sectoral credit is allowed to be taken. Service tax paid on input service is allowed to be used for duty payable on final products removed. Similarly, excise duty paid on inputs is allowed to be used for paying service tax on output service.

Example:

Duty paid on raw plastic for the manufacture of plastic furniture is ₹20,000 and service tax paid on transportation i.e. Goods Transport Agency of raw plastic of ₹10,000. The duty payable on the finished goods (plastic furniture) is ₹35,000 while paying the duty on plastic furniture; the manufacturer is allowed to deduct the amount already paid as excise duty and service tax (Input tax) on raw plastic. Thus, the net duty payable will be ₹5,000 only. Technically speaking, the manufacturer availed the cenvat credit to the extent of ₹30,000 that he paid on inputs and input service for manufacturing of plastic furniture.

Note: The provisions of CENVAT Credit Rules will be covered in detail at Professional Programme.

ROLE OF COMPANY SECRETARIES

There is a great scope for Company Secretaries in Practice in the area of service tax. A Practicing Company Secretary can render several services under the Service Tax such as;

- **Consultancy services:** The company secretaries can provide expertise services to their clients by explaining and interpreting the provisions of the transformed and upcoming legislations. For Example, the taxability of services shifted from selective approach to negative approach.
- **Compliance Services:** The Company Secretaries can help the client or employers to comply with the following procedural requirement:
 - (a) Registration
 - (b) Payment of tax
 - (c) Maintenance of books and records
 - (d) Availment and utilization of Cenvat Credit

- (e) Submissions of service tax returns.

– **Certified Facilitation Centres** (CFCs): Company Secretaries in Practice can set up CFCs under the Automation of Central Excise and Service Tax Project of CBEC to provide procedural compliance services to the assessees by charging fees.

LESSON ROUND UP

- **Registration of service tax:** Section 69 of the Finance Act, read with Rule 4 of the Service Tax Rules make provisions relating to registration. It is mandatory for every person liable to pay service tax to get registered with Superintendent of Central Excise. A person providing a taxable service is liable to pay service tax in terms of Section 68.
- An application for registration to the Superintendent of Central Excise can be made in form (ST-1). This is to be made within a period of thirty days from the date on which the service tax is leviable.
- **Payment of service tax:** With effect from 1st April 2011, Finance Act, 2011 introduced Point of Taxation (POT) Rules, 2011. These rules laid down the provisions relating to payment of service tax on accrual basis instead of receipt basis and specify the relevant date for determining rate of service tax. Point of taxation means the point in time when a service shall be deemed to have been provided. This Point of time will determine rate of service tax and due date of payment of service tax.
- **Reverse charge-** As per Section 68, every person providing taxable services i.e. provider of output service is liable to pay service tax. But in special cases service receiver is liable to pay service tax. This is known as reverse charge. Under this charge service receiver has to register himself under service tax. Further service receiver can not claim general exemption limit of 10 Lakhs rupees and he is liable to pay service tax even on small amount.
- Section 67 provides for the method of valuation of taxable services i.e. the value on which service provider is required to discharge service tax. As per section 67, the valuation of taxable service shall be determined under the following two situations:
 - Service tax is separately charged in the bill
 - Bill value is inclusive of service tax
- Abatement under service tax laws means that for certain services, a specified percentage of discount is allowed from the gross amount collected for rendering the services subject to the conditions that CENVAT Credit has not been availed by the service provider.
- **Adjustment of Service tax:** Where an assessee has paid to the credit of Central Government any amount in excess of the amount required to be paid towards service tax liability for a month or quarter, the assessee may adjust such excess amount paid by him against his service tax liability for the succeeding month or quarter.
- **Maintenance of Accounts:** Every assessee is required to furnish to the Superintendent of Central Excise at the time of filing his return for the first time, a list of all accounts maintained by him in relation to service tax including memoranda received from his branch offices.
- **Filing of return:** Rule 7 of the Service Tax Rules, 1994 return under Service Tax is required to be filed by every assessee on half yearly basis in Form ST-3 or Form ST-3A, as the case may be, along with a copy of the Form GAR -7, in triplicate for the months covered in the half-yearly return. Every assessee shall submit the half yearly return by the 25th of the month following the particular half-year.
- **E-filing of return:** With effect from 1st October, 2011, every assessee is required to file half yearly return electronically.

- **Interest on late payment of service tax:** Every person, liable to pay the tax in accordance with the provisions of section 68 or rules made thereunder, who fails to credit the tax or any part thereof to the account of the Central Government within the period prescribed, shall pay simple interest at such rate not below 10% and not exceeding 36% p.a.
- **Doctrine of unjust enrichment:** Since service tax is indirect tax, it is recoverable from customer. If you recover the amount from customer and again claim refund, you will get double benefit. Hence, provision of 'unjust enrichment' has been made in the law. As per the doctrine of unjust enrichment, refund will be granted to assessee only if assessee had not passed on the tax burden to your customer/client. It will be presumed that assessee has passed on the burden of service tax.
- **Penalties:** Various penalties have been provided under the Act. The penalties can be imposed by Central Excise Officers. There is no provision for prosecution under the Act.
- **Role of Company Secretaries:** The educational background, knowledge, training and exposure that a Company Secretary has, makes him a versatile professional capable of rendering a wide range of services to companies of all sizes, other commercial and industrial organizations, small scale units, firms etc.

SELF TEST QUESTIONS

These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation.

MULTIPLE CHOICE QUESTIONS

Choose the most appropriate answer from the given options in respect of the following:

1. What would be the value of taxable service, if gross amount charged by a service provider on 5th March, 2013 is ₹ 9,000 –
 - (a) ₹8,010
 - (b) ₹ 8,160
 - (c) ₹9,000
 - (d) ₹8,100.
2. If Radha has collected any amount of service tax from Bholu which is not required to be collected, Radha shall pay the amount so collected to –
 - (a) Bholu
 - (b) The Central Government
 - (c) Keep it with himself
 - (d) None of the above.
3. E-payment of service tax is compulsory in the case of an assessee who had paid service tax in the preceding financial year equal to at least –
 - (a) ₹10 lakh
 - (b) ₹ 40 lakh
 - (c) ₹ 50 lakh
 - (d) No limit

4. Upto what amount, the value of all taxable services provided by a service provider during a financial year is exempt from payment of service tax –
 - (a) ₹4 lakh
 - (b) ₹ 8 lakh
 - (c) ₹10 lakh
 - (d) ₹12 lakh.
5. If a corporate assessee has paid ₹ 15,000 as excess service tax during the previous half-year ending period, this excess amount can be adjusted against its subsequent tax liability –
 - (a) Equally every month
 - (b) Equally per quarter
 - (c) Equal to the service tax liability
 - (d) Equally on half-yearly basis.

TRUE AND FALSE

1. Recovery and adjustment of service tax means the same thing.
2. Return of service tax is required to be filed by every assessee in Form No. ST 3.
3. Registration is mandatory under the service tax.
4. No service tax is payable on free services.

FILL IN THE BLANKS

1. Maximum amount of penalty for late filing of service tax return is _____.
2. Under service tax rules, every assessee is required to furnish to _____ at the time of filing his return for the first time a list of all accounts maintained in relation to the service tax.
3. Service tax return can be revised within a period of _____ from the date of submission of return.
4. The application for registration shall be made within a period of _____ of commencement of business by an input service provider.
5. The registration certificate is issued to a service provider within 7 days by the _____.
6. Due date for payment of service tax in the case of individual assessee is _____ immediately following the quarter of the financial year except in case of last quarter.

ELABORATIVE

1. What are the various provisions relating to payment of service tax? Explain.
2. What are the provisions regarding penalties under service tax in the following cases :
 - (a) Failure to take registration.
 - (b) Failure to keep books of account.
 - (c) Failure to produce accounts and documents.
3. "The value of any taxable service shall be the gross amount charged by the service provider for such service rendered by him". In the light of this statement, explain how the value of taxable service is determined.

4. Briefly state the provisions relating to the procedure of registration under the service tax.
5. What are the due dates for payment of service tax by different assessees ?
6. Indicate the amount of interest payable for late payment of service tax and the amount of penalty payable for late filing of return of service tax.
7. Explain the provisions regarding submission of return under service tax.
8. What is the basis of calculation of service tax payable ? Explain the provisions governing valuation of taxable services.
9. "Service tax is generally payable by the service provider, but there are certain situations in which service receiver is liable to pay service tax." Explain.
10. Discuss 'advance ruling in service tax'.
11. Explain the provisions regarding service tax on Company Secretaries.

ANSWERS/HINTS

Multiple Choice Questions

1. (a); 2. (b); 3. (a); 4. (c); 5. (c)

True and False

1. False; 2. False; 3. False; 4. True;

Fill in the blanks

1. ₹20,000; 2. Superintendent of Central Excise; 3. 90 Days; 4. 30 Days; 5. Superintendent of Central Excise; 6. 5th of the month;

Test Your Knowledge

1. ₹9,00,000
2. 6th

SUGGESTED READINGS

1. Dr. V.K. Singhania : Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.
2. Girish Ahuja and Ravi Gupta : Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.
3. Service Tax Manual: Taxmann

Lesson 19

Value Added Tax – Introduction, Computation and Other Procedural Aspects

LESSON OUTLINE

- Introduction
- White paper
- Extracts from kelkar committee report
- Vat liability
- Advantages
- Methods of computation
- Procedure
- Rates of tax
- Distinction between existing system and vat registration
- Scheme of vat payment:
- Exempted sale
- Credit and set-off under vat
- Work contract tax
- Assessment
- Audit returns
- Zero rating refunds
- Scrutiny process
- Appeals, revision and appearances
- Withdrawal of central sales taxes
- Glimpse of CST
- Goods and Service Tax
- Lesson Round Up
- Self Test Questions

LEARNING OBJECTIVES

The Committee of Finance Minister (in 1995 and 1998) had put forward recommendations to replace sales tax by Value Added Tax (VAT). Further the conference of Chief Minister and the Finance Minister had proposed introduction of VAT by April 1, 2002 with uniform floor rates. The Empowered Committee of State Finance Ministers on February 8, 2003 again endorsed the suggestion that all the State legislations on VAT should have a certain minimum set of common features. Most of the States came out with their respective draft legislations. Shri Jaswant Singh the then Union Finance Minister, also announced the introduction of VAT from 1st April, 2003 in his 2003-2004 budget speech made on February 28, 2003. Owing to some unavoidable circumstances, VAT could not be implemented w.e.f. April 1, 2003 and also on the revised date June 1, 2003, Despite all obstacles, Haryana was the first State to implement VAT w.e.f. April 1, 2003. In rest of the States VAT Laws were at draft stage.

At the end of this lesson, you will

- Have an overview of the history of VAT
- Understand the basic concepts of VAT
- Understand the procedural aspects of VAT
- Learn the basic concepts of CST and GST.

VAT is a multi-stage tax on goods that is levied across various stages of production and supply with credit given for tax paid at each stage of Value addition. VAT is the most progressive way of taxing consumption rather than business.

INTRODUCTION

The Value Added Tax (VAT) in India is a state level multi-point tax on value addition which is collected at different stages of sale with a provision for set-off for tax paid at the previous stage i.e., tax paid on inputs. It is to be levied as a proportion of the value added (i.e. sales minus purchase) which is equivalent to wages plus interest, other costs and profits. It is a tax on the value added and can be aptly defined as one of the ideal forms of consumption taxation since the value added by a firm represents the difference between its receipts and cost of purchased inputs. Value Added Tax is commonly referred to as a method of taxation whereby the tax is levied on the value added at each stage of the production/distribution chain. As against the existing regime under which goods are charged to tax at Single point, or multi-point on the value of the goods, without any credit being given for taxes paid at the preceding stages. VAT intends to tax only the value added at each stage and not the entire invoice value of the product. By ensuring that only the incremental value is taxed, VAT aims at eliminating the cascading effect of taxes on commodities, and thereby reduces the eventual cost to the consumer.

It is one of the most radical reforms, albeit only in the sphere of State level taxes on sale, those have been initiated for the Indian economy after years of political and economic debate aiming at replacing complicated tax structure to do away with the fraudulent practices.

With the objective to introduce State-Level VAT in India in the Year 1992, the Government of India constituted a Tax Reform Committee headed by Dr. Raja J. Chelliah. In 1993, the Committee recommended the introduction of VAT in place of existing tax system. Thereafter, the Government appointed NIPFP (National Institute of Public Finance and Policy), New Delhi, as the Nodal Agency to work out the modalities of VAT.

The first preliminary discussion on State-Level VAT took place in a meeting of Chief Ministers convened by Dr. Manmohan Singh, the then Union Finance Minister in 1995. In this meeting, the basic issues on VAT were discussed in general terms and this was followed up by periodic interactions of State Finance Ministers.

For implementing the above decisions, an Empowered Committee of State Finance Ministers was set-up. Thereafter, this Empowered Committee met frequently and got full support from the State Finance Ministers, the Finance Secretaries and the Commissioners of Commercial Taxes of the State Governments as well as Senior Officials of the Revenue Department of the Ministry of Finance, Government of India. Through repeated discussions and collective efforts of all, it was possible to achieve remarkable success within a period of about one and half years. After reaching this stage, steps were initiated for the systematic preparation for the introduction of State-Level VAT.

Along with these measures ensuring convergence on the basis issues on VAT, steps were taken for necessary training, computerization and interaction with trade and industry, particularly at the State level. This interaction with trade and industry was specially emphasized. The conference of State Chief Ministers presided over by Shri Atal Behari Vajpayee, the then Prime Minister, held on October 18, 2002 at which Shri Jaswant Singh, the then Finance Minister was also present, confirmed the final decision that all the States and the Union Territories would introduce VAT from April 1, 2003.

A White Paper on State-Level Value Added Tax (VAT) by The Empowered Committee of State Finance Ministers (Constituted by the Ministry of Finance, Government of India on the basis of Resolution Adopted in the Conference of the Chief Ministers on November, 16, 1999, New Delhi, January 17, 2005. The Empowered Committee in the White Paper has justified the introduction of VAT in the following words :

"In the existing sales tax structure, there are problems of double taxation of commodities and multiplicity of taxes, resulting in a cascading tax burden. For instance, in the existing structure, before a commodity is produced, inputs are first taxed, and then after the commodity is produced with input tax load, output is taxed again. This causes an unfair double taxation with cascading effects. In the VAT, a set-off is given for input tax as well as tax paid on previous purchases. In the prevailing sales tax structure, there is in several states also a multiplicity of

taxes, such as turnover tax, surcharge on sales tax, additional surcharge, etc. With introduction of Vat, these other taxes will be abolished. In addition, Central Sales Tax is also going to be phased out. As a result, overall tax burden will be rationalized, and prices in general will also fall. Moreover, VAT will replace the existing system of inspection by a system of built-in self-assessment by the dealers and auditing. The tax structure will become simple and more transparent. That will improve tax compliance and also augment revenue growth. The VAT will therefore help common people, traders, industrialists and also the Government. It is indeed a move towards more efficiency, equal competition and fairness in the taxation system.

The first preliminary discussion on state-level VAT took place in a meeting of Chief Ministers convened by Dr. Manmohan Singh, the Union Finance Minister in 1995. In this meeting, the basic issues on VAT were discussed in general terms and this was followed up by periodic interactions of States Finance Ministers. Thereafter, in a significant meeting of all Chief Ministers, convened on November 16, 1999 by Shri Yashwant Sinha, the then Union Finance Minister, three important decisions were taken. First, before the introduction of State-level VAT, the unhealthy sales tax rate "war" among the States would have to end and sales tax rates would need to be harmonized by implementing uniform floor rates of sales tax for different categories of commodities with effect from January 1, 2000. Second, in the interest again of harmonization of incidence of sales tax, the sales-tax-related industrial incentive schemes would also have to be discontinued with effect from January 1, 2000. Third, on the basis of achievement of the first two objectives steps would be taken by the states for introduction of State-level VAT after adequate preparation. For implementing these decisions, an Empowered Committee of State Finance Ministers was set-up.

Thereafter, this Empowered Committee has met regularly, attended by the state Finance Ministers, and also by the Finance Secretaries and the Commissioners of Commercial Taxes of the State Governments as well as senior officials of the Revenue Department of the Ministry of Finance, Government of India. Through repeated discussions and collective efforts in the Empowered Committee, it was possible within a period of about a year and a half to achieve nearly 98 per cent success in the first two objectives on harmonization of sales tax structure through implementation of uniform floor rates of sales tax and discontinuation of sales-tax related incentive schemes. As a part of regular monitoring, whenever any deviation is reported from the uniform floor rates of sales tax, or from decision on incentives, the Empowered Committee takes up the matter with the concerned state and also the Government of India for necessary rectification.

Test Your Knowledge



1. Which of the following agency was appointed as the Nodal Agency to work out the modalities of VAT?

- (a) National Institute of Public Finance and Policy
- (b) National Institute of Finance
- (c) Institute of Financial Planning
- (d) Finance Ministry

The Committee of Finance Minister (in 1995 and 1998) have put forward recommendations to replace sales tax by Value Added Tax (VAT). Further the conference of Chief Minister and the Finance Minister has proposed introduction of VAT by April 1, 2002 with uniform floor rates. The Empowered Committee of State Finance Ministers on February 8, 2003 again endorsed the suggestion that all the State legislations on VAT should have a certain minimum set of common features. Most of the States came out with their respective draft legislations. Shri Jaswant Singh the then Union Finance Minister, also announced the introduction of VAT from 1st April, 2003 in his 2003-2004 budget speech made on February 28, 2003. Owing to some unavoidable circumstances,

VAT could not be implemented w.e.f. April 1, 2003 and also on the revised date June 1, 2003. Despite all obstacles, Haryana was the first State to implement VAT w.e.f. April 1, 2003. In rest of the States VAT Laws were at draft stage.

WHITE PAPER

The Empowered Committee of the State Finance Ministers constituted by the Ministry of Finance, Government of India, on the basis of the resolution adopted in the conference of the Chief Ministers on November 16, 1999 under the Chairmanship of Dr. Asim Dasgupta came out with a White Paper on State-Level VAT, which was released on January 17, 2005 by Shri P. Chidambaram, The Finance Minister, Government of India. On this occasion the Finance Minister remarked :

“This is the first document which has been collectively prepared and put out to the people of the country by the Finance Ministers of all States.... We have formed the rainbow coalition to undertake one of the biggest tax reforms.”

This Paper consists of three parts. In Part I, justification of VAT and the background has been mentioned. In Part II, main Design of VAT as evolved on the basis of consensus among the States through repeated discussions in the Empowered Committee has been elaborated. In Part III, other related issues for effective implementation of VAT have been discussed.

The White Paper specified that registration under the VAT Act shall not be compulsory for the small dealers with gross annual turnover not exceeding ₹5 lakh. However, the Empowered Committee of State Finance Ministers has subsequently allowed the States to increase the threshold limit for the small dealers to ₹10 lakh, but the concerned State shall have to bear the revenue loss, on account of increase in the limit beyond ₹5 lakh. The VAT Acts are designed so that high value taxpayers should not be spared and on the contrary small dealers should be hassle free from compliance procedures.

The objective of all such composition schemes is not to burden small dealers by the provisions of record keeping. Therefore, such schemes will generally contain the following features:

- (i) small amount of tax shall be payable;
- (ii) there shall be no requirement to calculate taxable turnover;
- (iii) a simple return form to cover longer return period shall be sufficient.

All sales or purchases of goods made within the State except the exempted goods would be subjected to VAT as a consumption tax.

In his speech introducing Union Budget 2005-06, the Hon'ble Finance Minister said, “In a remarkable display of the spirit of cooperative federalism, the States are poised to undertake the most important tax reform ever attempted in this country. All States have agreed to introduce the Value Added Tax (VAT) with effect from April 1, 2005. VAT is a modern, simple and transparent tax system that will replace the existing sales tax and eliminate the cascading effect of sales tax.

In the medium to long term, it is my goal that the entire production/distribution chain should be covered by a national VAT, or even better, a goods and services tax, encompassing both the Centre and the States.

The Empowered Committee of the State Finance Ministers, with the solid support of the Chief Ministers, has laboured through the last seven years to arrive at a framework acceptable to all States. The Central Government has promised its full support and has also agreed to compensate the States, according to an agreed formula, in the event of any revenue loss. I take this opportunity to pay tribute to the Empowered Committee, and wish the States success on the introduction and implementation of VAT”.

Test Your Knowledge

2. Which of the following was the first State to implement VAT w.e.f. April 1, 2003?
- Maharashtra
 - Punjab
 - Haryana
 - Karnataka

EXTRACTS FROM KELKAR COMMITTEE REPORT

Considering that the implementation of VAT was closely linked to the administration of other indirect taxes and impacts the tax to GDP ratio, it had become necessary to examine the relevant issues. In this direction the Task Force has had the benefit of meeting with the Empowered Committee of the Finance Ministers of the States, constituted for the purpose of implementing a nationwide State-level VAT. The Empowered Committee experimented on federal fiscal planning and achieved much in terms of building a consensus on many of the critical issues relating to implementation of VAT in a relatively short spell of time. Most countries have taken several years to implement VAT. Decisions were taken on the important features of VAT relating to replacement of the State Tax levied by the States though some other local taxes like octroi, mandi, cess etc. may continue.

It was recommended that a publicity awareness programme shall be started jointly by the Central Government and the State Governments. The Central Government shall extend financial support for this, if needed. Since the State VAT is expected to be implemented from 1.4.2003, it is also necessary that the publicity awareness programme should be implemented at the earliest.

One of the issues which had impact on the transition of VAT was the compensation to be given to the States upon the removal of Sales tax and the introduction of State VAT, in the event the tax revenue drops due to the changeover. In this regard it had been observed that the experience worldwide has been that a move towards VAT results in higher revenue realization.

During the meetings that the Task Force had with several industry and trade bodies, it was represented that the switch-over to VAT must ensure that the desired benefits are achieved, especially in view of the fact that this switch-over shall entail a major overhaul of systems and procedures for business and governments and at substantial expenditure of money, time and effort.

Under the existing sales-tax structure, there are problems of double taxation of commodities and multiplicity of taxes resulting in a cascading tax burden. As per the existing structure before a commodity is produced, inputs are first taxed and then after the commodity is produced with input tax load, output is taxed again. This causes an unfair double taxable with cascading effects. In the VAT, a set-off is given for input tax as well as tax paid on previous purchases.

The design of State-level VAT has been worked out by the Empowered Committee through several rounds of discussions and striking a federal balance between the common points of convergence regarding VAT and flexibility for the local characteristics of the States.

VAT LIABILITY

The Value Added Tax (VAT) is based on the value addition to the goods and the related VAT liability of the dealer is calculated by deducting input tax credit from tax collected on sales during the payment period (say, a month).

The White Paper specifies that registration under the VAT Act is not compulsory for the small dealers with gross annual turnover not exceeding ₹5 lakh. However, the Empowered Committee of State Finance Ministers has subsequently allowed the States to increase the threshold limit for the small dealers to ₹10 lakh, but the concerned States will have to bear the revenue loss on account of increase in the limit beyond ₹5 lakh.

VAT is so designed that high value taxpayers are not spared and on the contrary small dealers are also hassle free from compliance procedures.

ADVANTAGES

Various advantages of introducing VAT:

- to encourage and result in a better-administered system;
- to eliminate avenues of tax evasion;
- to avoid under valuation at all stages of production and distribution;
- to claim credit on tax paid on inputs at each stage of value addition;
- do away with cascading effect resulting in non distortion of the business decisions;
- permits easy and effective targeting of tax rates as a result of which the exports can be zero-rated;
- ensures better tax compliance by generating a trail of invoices that supports effective audit and enforcement strategies;
- contribution to fiscal consolidation for the country. As a steady source of revenue, it shall reduce the debt burden in due course;
- to help our country to integrate better in the WTO regime;
- to stop the unhealthy tax-rate war and trade diversion among the States, which had adversely affected the interests of all the States in the past.

METHODS OF COMPUTATION

VAT can be computed by using any of the three methods detailed below:

1. The Subtraction method: Under this method the tax rate is applied to the difference between the value of output and the cost of input;
2. The Addition method: Under this method value added is computed by adding all the payments that are payable to the factors of production (viz., wages, salaries, interest payments, etc.);
3. Tax Credit method: Under this method, it entails set-off of the tax paid on inputs from tax collected on sales. Indian States opted for tax credit method, which is similar to CENVAT.

PROCEDURE

The VAT is based on the value addition to the goods and the related VAT liability of the dealer is calculated by:

- Deducting input tax credit from tax collected on sales during the payment period.
- This input tax credit is given for both manufacturers and traders for purchase of input/supplies meant for both sales within the State as well as to the other States irrespective of their date of utilization or sale.
- If the tax credit exceeds the tax payable on sales in a month, the excess credit will be carried over to the end of the next financial year.

- If there is any excess unadjusted input tax credit at the end of the second year then the same will be eligible for refund.
- For all exports made out of the country, tax paid within the State will be refunded in full.
- Tax paid on inputs procured from other States through inter-State sale and stock transfer shall not be eligible for credit.
- VAT has been introduced by 30 States / UTs. However, Central Sales Tax will continue to govern inter-State Sales and Exports.

Test Your Knowledge



- 3. Under which method is the rate of tax applied to the difference between the value of output and the cost of input?**
- Subtraction method
 - Addition method
 - Tax Credit method
 - None of the above

RATES OF TAX

Four Types of VAT Rates: As contrasted to the multiplicity of rates under the existing regime, VAT will have 4 broad rates.

- 0% (Exempted) for unprocessed agricultural goods, and goods of social importance)
- 1% for precious and semiprecious metals,
- 4% for inputs used for manufacturing and on declared goods, capital goods and other essential items,
- 20% for demerit/luxury goods and
- the rest of the commodities will be taxed at a Revenue Neutral Rate of 12.5%.

DISTINCTION BETWEEN EXISTING SYSTEM AND VAT

S.No.	<i>Existing System</i>	<i>VAT System</i>
1.	Earlier the local sales tax was based on single point tax. The single point tax was either at first point or at last point. The First point tax (FPT) was convenient to the revenue but had inbuilt cascading effect. The Last Point Tax (LPT) is an ideal system but it was evasion prone. Creates loss of revenue to the government.	The VAT system on the other hand reduces the disadvantages of both FPT and LPT and at the same time draws the advantages from both. The VAT system obviously is more transparent, uniform and less prone to tax evasion.
2.	States continue to tax declared goods on single point basis under the existing system subject to a rate of 4%.	Under VAT, declared goods will also suffer tax at multiple levels
3.	Under the existing Sales tax systems, inputs used for manufacture, whether capital or otherwise,	However, under the VAT system, there is no place for concessions. Goods will be taxed at their

	are eligible for concessional rate of tax on furnishing the requisite forms.	respective rates, of course, with a provision for set off in future. There will be no incentive schemes under VAT, barring those carried forward from the existing system.
4.	The exports are exempt from tax and supplies to exporters i.e. penultimate sales are also exempt subject to certain conditions.	Under VAT, exports are zero rated i.e. they are not exempted, giving rise to refund of tax paid on inputs.
5.	There is no set off of prior taxes paid under the existing system of Single Point Tax and Multi-point tax.	In the VAT system, all prior taxes are given setoff against output tax if the sale is not an exempt sale.

The following illustration may show the difference between first point tax and last point tax.

Assume the base price of the commodity is ₹1000 and the government wishes to collect sales tax of 10% on base price i.e. ₹100.

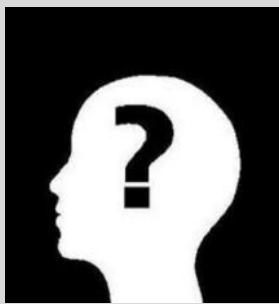
Taxation

F.P.T.	₹	L.P.T.	₹
Price paid by A	1,000	Price paid by A	1,000
Tax paid by A	100	Tax paid by A	Nil
Total	1,100	Total	1,000
Margin @ 50% added by A	550	Margin added by A @50%	500
Price paid by B	1,650	Price paid by B	1,500
Margin @ 50% added by B	825	Margin @50% added by B	750
	2,475		2,250
Tax	Nil	Tax	100
Price paid by Consumer	2,475	Price paid by Consumer	2,350

In both the cases as above, the tax collected by the government is ₹ 100 but consumer would pay more under F.P.T. than under L.P.T. Under VAT, the consumer would pay the same amount as under F.P.T. but the government would get the tax of ₹ 225/- instead of ₹ 100/-

VAT Regime

- The rates shall be uniform. However, it is possible that items under the exempted category and 4% category may be broadly similar across all States.
- Each State has its own VAT Act, Rules, Schedules, and Forms. therefore there will remain differences even in definitions among various Acts.
- Petroleum products, like Aviation Turbine Fuel, Naphtha, etc. used as fuel for running automobiles are brought under VAT, but credit cannot be taken on the tax paid thereon.
- Tobacco, Textiles and Sugar, which were under additional duty in lieu of excise and not under State taxation, are brought into the State Tax net at a rate not more than 4%, thereby integrating these products in the VAT structure.

Test Your Knowledge**4. What is the rate of VAT for precious and semiprecious metals?**

- (a) 0%
- (b) 3%
- (c) 4%
- (d) 1%

REGISTRATION

Every dealer up to the retailer level is required to be registered with the Sales Tax department to avail the credit of input tax. However, there would be a threshold turnover level. The retailers with turnover below the threshold can opt not to register, but pay a nominal composition tax. However, such dealers are not entitled to take credit of prior stage tax, nor can they pass the credit to their buyers. In effect, the VAT chain breaks at their stage. Those opting not to register under VAT can opt for general registration.

Registration of dealers with gross annual turnover above the threshold limit will be compulsory. There will be provision for voluntary registration for dealers with gross annual turnover of less than the threshold limit. All existing dealers will be automatically registered under the VAT Act. A new dealer will be allowed 30 days time from the date of his being liable to get registered.

SCHEME OF VAT PAYMENT

Small dealers with gross annual turnover not exceeding the threshold limit will not be liable to pay VAT. States will have flexibility to fix threshold limit within ₹10 lakh. Small dealers with annual gross turnover not exceeding ₹25 lakh who are otherwise liable to pay VAT, shall however have the option for a composition scheme with payment of tax at a small percentage of gross turnover. The dealers opting for this composition scheme will not be entitled to input tax credit.

TAX INVOICE

This entire design of VAT with input tax credit is crucially based on documentation of tax invoice, cash memo or bill. Every registered dealer, having turnover of sales above an amount specified, shall issue to the purchaser [who is entitled to tax credit and not to the final consumer] serially numbered tax invoice with the prescribed particulars. This tax invoice will be signed and dated by the dealer or his regular employee, showing the required particulars.

EXEMPTED SALE

When a certain sale is exempted from tax, the dealer effecting the exempt sale will not be entitled to any VAT credit on the inputs purchased by him. The sale effected by him will also be exempt from any tax. This results in breaking of the VAT chain.

SAMPLES OR GIFTS

Another example where reversal will be required is when goods are sold as samples or gifts i.e., non-taxable transactions and the input tax credit relating thereto has already been availed against output tax payable on other sale transactions. In such circumstances, the credit earned will be reversed. This is called "Reverse Credit of Input Tax".

CONSIGNMENT TRANSFER

Stock/Consignment transfers are exempt from VAT as these were never under the purview of the State Tax Acts. The input tax paid on such commodities or on the inputs that go into producing such commodities can be taken credit to the extent of excess of input tax over and above 4%. Thus, if the input used in the commodity that is transferred, or the product itself when purchased, was taxed at say 10%, credit can be taken by the transferring dealer to the extent of 6% against other taxable dispatches.

Imported goods will continue to be exempt from VAT on imports. Under VAT, there is no place for Entry taxes and Octroi.

CREDIT AND SET-OFF UNDER VAT

VAT aims at providing set-off for the tax paid earlier and this is given effect through the concept of input tax credit.

Input tax credit in relation to any period means setting the amount of input tax by a registered dealer against the amount of his output tax.

Tax paid on the earlier point is termed as, "input tax". This amount is adjusted against the tax payable by the purchasing dealer on his sales. This credit availability is called input tax credit.

Input tax is the tax paid or payable in the course of business on purchase of any goods made from a registered dealer of the State.

Output tax means the tax charged or chargeable under the Act, by a registered dealer for the sale of goods in the course of business.

In simple words, input tax is the tax a dealer pays on his local purchases of business inputs which include raw materials, capital goods as well as other inputs used directly or indirectly in his business. Output tax is the tax that a dealer charges on his sales that are subject to tax.

The input tax credit is to be given for both manufacturers and traders for purchase of inputs/ supplies meant for both sale within the State as well as to other States, irrespective of when these were utilized or sold. This also reduces immediate tax liability.

Input tax paid in excess of 2% on stock transfers to other states will be eligible for tax credit. It is also to be noted that in certain cases, partial input tax credit is available in respect of input used for manufacture of exempted goods.

Input tax credit is allowable to a registered dealer for purchase of any goods made within the State from a dealer holding a valid certificate of registration under the Act. Input tax credit on capital goods is available for traders and manufacturers.

No input credit on CST paid on purchases from other states: Central sales tax paid on inter-state purchases is not eligible for being set off against Value Added Tax payable in the state..

Input tax on capital goods: While taxes paid on raw materials and inputs are eligible for set off against taxes on output, taxes paid on capital goods are not eligible for immediate set-off. The reason perhaps is the huge credit that States may have to grant in cases of capital purchases of large value. Due to this, tax on capital goods may be granted, but over a certain period of time.

Input tax in case of export sales: Export sales are zero rated and thereby exporters are either granted refund of input taxes paid by them or they can adjust such input tax while making domestic sales.

In some cases, the input tax paid and taken credit of, may have to be reversed as such, for example, when the material is consumed for personal purposes and not for business purposes, or when the input including packing materials is used for manufacture and/or sale as exempt goods etc.

All tax-paid goods purchased on or after April 1, 2004 and still in stock as on April 1, 2005 will be eligible to receive input tax credit, subject to submission of requisite documents. Resellers holding tax-paid goods on April 1, 2005, and input tax credit shall be given for the sales tax already paid in the previous year. This tax credit shall be available over a period of 6 months after an interval of three months needed for verification.

WORK CONTRACT TAX

Some contracts are contracts for labour, work or service and not for sale of goods, though goods are in use in executing the contract for labour, work or service e.g., when a contractor constructs a building, the buyer pays for cost of building material labour and other services offered by the contractor. Property in the building is passed on to the buyer and there is no contract for supply of building material as such.

It is quite difficult to establish whether particular contract is 'contract for work' or contract of sale. For this any rigid test is not possible. It depends upon the main object of the parties, circumstances and custom of trade. Generally a contract of sale is a contract whose main object is to transfer of property in and delivery and possession of a chattel as a chattel to the buyer. In the case of *Vanguard Rolling Shuttles v. CST AIR 1977 CS 1505*, the supreme has observed that it is very difficult to lay down any universal technique to determine what is contract of sale or what is job contract. In a recent case of *ACC Limited v. CC AIR 2001 SC 862*. The Supreme Court held that even if the dominant intention of the contract is rendering of service which will amount to a works contract after 46th Amendment to the Constitution. The State would now be empowered to levy sale tax on material used in such contract.

In the case of *Cooch Bihar Contractors Association v. State of West Bengal* (1996) 103 STC 477 (SC), it was held by the Hon'ble Court if contractor has to pay royalty and property gets transferred to him, it can be included for the purpose of work contract Act.

Many High courts have held that C Form can be issued for purchase of goods which are used in works contract. The dealer is entitled to registration and he can receive sales tax forms in respect of his sales.

Central Sales Tax will be payable on goods involved in works contract if goods moved from one state to another on account of such works contract from 11.5.2002 onwards.

There can certainly be inter-state works contract in case of movable property e.g., printing contracts. In fact CST can be levied on any goods involved in works contract in case of movable property.

Test Your Knowledge



5. Which of the following tax is paid by the dealer on his/her local purchases of business inputs?

- (a) Input tax
- (b) Output Tax
- (c) First Point Tax
- (d) Last Point Tax

ASSESSMENT

The VAT liability shall be self-assessed by the dealer himself. It pre-supposes that all the dealers act in honest manner. Scrutiny may be done in cases where there are doubts arising due to under reporting of transactions or evasion of tax.

VAT AUDIT

There shall no longer be compulsory assessment at the end of each year. Correctness of self-assessment shall be checked through a system of Vat Audit. A certain percentage of the dealers shall be taken up for audit every year on a scientific basis. In case of detection of evasions during the course of audits, the concerned dealer may be taken up for audit for previous periods. This Audit Wing shall remain delinked from tax collection wing to remove any bias. The audit team shall conduct its work in a time bound manner and audit shall be completed within six months and the audit report shall be transparently sent to the dealer as well.

Simultaneously, a cross-checking through computerized system shall be done on the basis of coordination between the tax authorities of the State Governments and the authorities of Central Excise to compare constantly the tax returns and set-off documents of VAT system of the States and those of Central Excise. This comprehensive cross-checking system shall help reduction in tax evasions and also lead to significant growth of tax revenue.

In many states other than the Departmental Audit, audit of accounts by Accountant is made mandatory where the turnover exceeds the prescribed limit.

RETURNS

The return filing procedures are designed in such a way that the compliance costs are minimum. A registered dealer shall be required to file a return along with the requisite details such as output tax liability, value of input tax credit, and payment of VAT.

Under VAT there exist simple forms of returns, which shall be filed monthly or quarterly or annually as per the provisions of various State laws. Returns shall be accompanied with the challans evidencing payment of tax. In certain States, returns cum challan forms have been devised. In those cases, the returns along with the payment have to be filed with the treasury.

Every return so furnished is required to be scrutinized expeditiously within the prescribed time limit from the date of filing the return. If any technical mistake is detected on scrutinizing, the dealer shall be required to rectify the defect or pay the deficit respectively.

ZERO RATING

Zero Rating means that the tax payable on sale of a commodity is fixed at 0%. Though apparently, it looks similar to an exempted transaction, there is a significant difference between the two. While in an exempted transaction, the tax paid on input lapses i.e. it cannot be set off, under the Zero rated sales, prior stage tax is set off against the 0% tax paid, and effectively the entire tax paid on purchases is eligible for refund. Thus, 'Zero Rating' is advantageous to the dealer compared to 'exempting' of sale transactions. Generally, export sales are zero rated and thereby, exporters are granted refund of taxes paid by them on their inputs. Exporters gain significantly due to the 'Zero Rating'.

REFUNDS

Refunds are to be granted by the end of the financial year. Thus, the benefit of zero rating is not immediate, but deferred. Some States have also provided for refund where the tax paid on inputs exceeds the output tax payable and cannot be set off in a given period. In such cases, the excess tax not so set off shall be refunded after adjusting any dues towards interest, penalty, etc., in accordance with the State VAT Act.

SCRUTINY PROCESS

The correctness of self assessment will be checked through a system of departmental audit. It is a sample audit by which a certain percentage of assessees or dealers are taken on scientific basis for audit purposes. If it is found that some of the dealers deliberately defalcated their dues for the particular Financial Year then the department will carry out audit of previous financial years. The audit wing is separated from the collection wing in order to ward off

any kind of biasness. The entire audit process is conducted in a transparent way and such process should be completed within six months. The audit report should be provided to the dealer and other concerned persons. Simultaneously a cross checking computerized system is also being used in coordination with tax authorities of the State Governments and the authorities of Central Excise and Income Tax to compare the tax returns and set off documents of VAT system of the states and those of Central Excise and Income Tax. This comprehensive cross checking will help to reduce tax evasion and also lead to significant growth in tax base of the country.

APPEALS, REVISION AND APPEARANCES

As we know that in India there is no central Value Added Tax Act till now. The reason being sales tax is state subject found in List II of the Seventh Schedule of our Constitution. As a result the Central Government cannot use their prerogative to institute in a Central Act governing VAT in our country. There is no consensus among states to introduce a unique Act which will apply to all states and union territories without any reservation and constraints. The eventuality is being separate states have their own VAT Act and those states which do not have the relevant Act are in the process of making them. The States making those Acts is according to their own conveyance and likings which serves their interest more profoundly. Since different states and union territories have their own VAT Act and Rules, the appeal, revision and other relevant issues are explained differently. As a result any representative provisions relating to appeals, revision and appearances cannot be stated. It is worth mentioning that some states have recognised till now company secretaries as authorised representative to represent their client's case before any VAT authority. The states are West Bengal, Gujarat, Bihar, Goa and Karnataka. Other states are in the process of recognizing company secretaries as professionals who can appear before their respective VAT authorities.

Test Your Knowledge



6. What are some of the advantages of introducing VAT?

- (a) Encouraging and resulting in a better-administered system
- (b) Avoiding under valuation at all stages of production and distribution
- (c) Retaining cascading effect resulting in non distortion of the business decisions
- (d) Claiming credit on tax paid on inputs at each stage of value addition

CENTRAL SALES TAX

Central sales tax (CST) is a tax on sales of goods levied by the Central Government of India. It extends to the whole of India. The Central Sales Tax is levied under this act by the Central Government but, it is collected by that state government from where the goods were sold. The tax thus collected is given to the same state government which collected the tax. In case of Union Territories the tax collected is deposited in the consolidated fund of India.

Every dealer who makes an inter-state sale must be a registered dealer and a certificate of registration has to be displayed at all places of his business. There is no exemption limit of turnover for the levy of central sales tax.

CST is applicable only in the case of inter-state sales and not on sales made within the state or import/export of sales. The interstate nature of transaction is to be determined as defined in Section 3(a)/(b). If sale/purchase occasions movement of goods from one State to another State, it is an interstate sale. Thus, consignments to agents or transfer of goods to branch or other offices are not a sale. A sale, effected by transfer of documents of title to goods when goods are in inter-state movement, is also an inter-state sale.

Under this act, the goods have been classified as:

- Declared goods or goods of special importance in inter-state trade or commerce and
- Other goods.

The rates of tax on declared goods are lower as compared to the rate of tax on goods in the second category.

However, goods that are sold within a state, but while travelling through another state is not considered as inter state sales.

The rules regarding submission of returns, payment of tax, appeals etc. are not given in the Act. For this purpose, the rules followed by a state in respect of its own sales tax law shall be followed for purpose of this Act also. Even though the central sales tax has been framed by the central government but, the state governments are allowed to frame such rules, subject to such notification and alteration as it deem fit.

SOME IMPORTANT DEFINITIONS

Declared goods [section 2(c)]

It includes those goods which are considered to be of special importance in interstate trade or commerce under section 14. Some of these goods is –

- cereals
- coal
- cotton
- crude oil
- jute
- oilseeds
- Pulses
- sugar

Goods [section 2(d)]

This includes all material articles or commodities and all kind of Movable property excluding newspapers, actionable claims, stocks, shares and securities. If newspapers are sold as scrap then, it will be charged to central sales tax if it is an inter- state sale.

Sale [section 2 (g)]

It means transfer of property in goods by one person to another for cash or for deferred payment or for any valuable consideration. However, a mortgage, hypothecation of, or a charge, or pledge on goods is not included.

Essential elements of sale:

- goods should be transferred
- general property in good should be transferred
- price must be paid
- there must be a seller and a buyer
- there must be a valid consent of both buyer and seller

Sale price [section 2 (h)]

It means amount payable to a dealer as consideration for the sale of any Goods which includes the following –

- central sales tax
- excise duty
- cost of packing material
- packing charges
- bonus given for effecting additional sales
- insurance charges, if goods are insured by seller
- freight charges if, not shown separately
- any sum charged for anything done by the dealer in respect of goods at the time of or before delivery thereof;

Sale price does not include the following -

- freight or transport charges for delivery of goods, if charged separately
- cost of installations, if charged separately
- cash discounts for making timely payments.
- trade discount
- insurance charges of goods insured on behalf of the buyer
- goods rejected
- goods returned within 6 months of the date of sale

Turnover [section 2 (j)]

It is the aggregate of the sale prices received and receivable by the dealer in respect of sales of any goods in the course of inter-state trade or commerce made during a prescribed period. Prescribed period is the period in which sales tax return is filed.

Section 4 of the CST Act determines situs of sale: i.e. State in which the sale takes place. Accordingly the situs is to be decided on the location of the goods at the time of sale.

Section 5 defines the sale/purchase taking place in course of import/export and such transactions are immune from levy of any tax by State Government or Central Government. [(Sections 5(1), 5(2) and 5(3)].

The sale of goods to any exporter for the purpose of complying with the pre-existing order and covered by Section 5(3) is also exempt as deemed export. These sales are to be supported by Form H along with export order details and copy of bill of lading etc. as evidence of actual export.

Determination of Turnover

As per section 8 (A), to determine turnover following amounts will be deducted –

- Central sales tax
- Sale price of goods returned within six months
- Other items as the central government may notify

Central Sales Tax

If tax forms a part of aggregate sales price then amount of tax collected by a registered dealer shall be deducted from his gross turnover. Tax is calculated by the following formula.

$$\frac{\text{Rate of tax} \times \text{Aggregate of sales price}}{100 \div \text{Rate of tax}}$$

If the turnover of a dealer is taxable at different rates, then above formula shall be applied separately in respect of each part of the turnover liable to a different rate of tax.

Registration of Dealers

According to Section 7, registration of dealer can be done in any of the two ways-

1. Compulsory registration
2. Voluntary registration

WITHDRAWAL OF CENTRAL SALES TAXES

Presently, CST will continue, though it is proposed to be phased out in due course. The provisions in respect of Central Tax are summarized below :

- (i) CST may go after decision in respect of loss of revenue to States is taken and comprehensive Taxation information System is put in place [Para 4.3 of White Paper on State-Level VAT]. Note that CST has been reduced to 3% w.e.f. 1.4.2007, and further reduced to 2% w.e.f. 1.6.08.
- (ii) Present forms i.e., C, D, E-I/E-II and H will continue, Form No. D has been abolished w.e.f. 1.4.2007.
- (iii) There will be no credit of CST paid on inter-state purchases [Para 2.6 of White Paper on State-Level VAT]
- (iv) If goods are sent on stock transfer outside the State, input tax paid in excess of 2% will be allowed as credit. In other words, input tax to the extent of 2% will not be allowed as credit if goods are sent inter-state.

GOODS AND SERVICE TAX

Introduction of the Value Added Tax (VAT) at the Central and the State level has been considered to be a major step and important breakthrough in the sphere of indirect tax reforms in India. If the VAT is a major improvement over the pre-existing Central excise duty at the national level and the sales tax system at the State level, then the Goods and Services Tax (GST) will indeed be a further significant improvement the next logical step towards a comprehensive indirect tax reforms in the country.

The Empowered Committee of State Finance Ministers is working with the Central Government to prepare a roadmap for introduction of GST in India. The Empowered Committee has brought the First Discussion Paper on GST on 9th Feb. 2010 which deals with the outlines of GST. Detailed views of the Empowered Committee on the structure of GST is presented in terms of the First Discussion Paper, along with an Annexure on Frequently Asked Questions and Answers on GST, for discussions with industry, trade, agriculture and people at large.

Further, Constitutional amendment bill, was also introduced in the parliament to resolve the issues arising between the state and centre relating to revenue. Government is taking wider steps for early implementation of GST like setting up of GST network etc. However, the date of implementation of GST not yet been finalized.

LESSON ROUND UP

Background: The Value Added Tax (VAT) in India is a state level multi-point tax on value addition which is collected at different stages of sale with a provision for set-off for tax paid at the previous stage i.e., tax paid on inputs. It is to be levied as a proportion of the value added (i.e. sales minus purchase) which is equivalent to wages plus interest, other costs and profits. It is a tax on the value added and can be aptly defined as one

of the ideal forms of consumption taxation since the value added by a firm represents the difference between its receipts and cost of purchased inputs.

Advantages of VAT: Encourage a better-administered system; Eliminate tax evasion; Avoid under valuation; avail tax credit; do away with cascading effect; permits easy and effective targeting of tax rates; ensures better tax compliance; contribution to fiscal consolidation for the country

Methods of VAT: Subtraction method, Addition method and Tax Credit method.

Rate of VAT:

- 0% (Exempted) for unprocessed agricultural goods, and goods of social importance), 1% for precious and semiprecious metals,
- 4% for inputs used for manufacturing and on declared goods, capital goods and other essential items,
- 20% for demerit/luxury goods and
- the rest of the commodities will be taxed at a Revenue Neutral Rate of 12.5%.

Registration: Registration of dealers with gross annual turnover above the threshold limit will be compulsory. There will be provision for voluntary registration for dealers with gross annual turnover of less than the threshold limit

Exempted Sale: When a certain sale is exempted from tax, the dealer effecting the exempt sale will not be entitled to any VAT credit on the inputs purchased by him

VAT Credit: VAT aims at providing set-off for the tax paid earlier and this is given effect through the concept of input tax credit.

Works Contract Tax: Some contracts are contracts for labour, work or service and not for sale of goods, though goods are in use in executing the contract for labour, work or service e.g., when a contractor constructs a building, the buyer pays for cost of building material labour and other services offered by the contractor.

VAT Audit: There shall no longer be compulsory assessment at the end of each year. Correctness of self-assessment shall be checked through a system of Department Audit. A certain percentage of the dealers shall be taken up for audit every year on a scientific basis

Filing of Return: The return filing procedures are designed in such a way that the compliance costs are minimum. A registered dealer shall be required to file a return along with the requisite details such as output tax liability, value of input tax credit, and payment of VAT.

Central Sales Tax: Central sales tax (CST) is a tax on sales of goods levied by the Central Government of India. It extends to the whole of India. Every dealer who makes an inter-state sale must be a registered dealer and a certificate of registration has to be displayed at all places of his business.

Withdrawal of CST: Presently, CST will continue, though it is proposed to be phased out in due course.

Goods and Service Tax: Introduction of the Value Added Tax (VAT) at the Central and the State level has been considered to be a major step and important breakthrough in the sphere of indirect tax reforms in India. If the VAT is a major improvement over the pre-existing Central excise duty at the national level and the sales tax system at the State level, then the Goods and Services Tax (GST) will indeed be a further significant improvement the next logical step towards a comprehensive indirect tax reforms in the country.

SELF TEST QUESTIONS

These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation.

TRUE AND FALSE

1. Value added tax (VAT) is levied by the Central Government.
2. VAT is a multi-point tax.
3. VAT system has six broad tax rates.
4. VAT system is followed by all states in India.
5. Registration of dealer is mandatory under VAT.
6. Input VAT credit is available on inter-state purchases.
7. Haryana was the first state to implement VAT in India.
8. Zero-rating is advantageous to the dealer compared to exempting of sale transactions.
9. Stock/consignment transfers are exempt from VAT.

ELABORATIVE

1. What is 'white paper'? What are the different parts of white paper under value added tax (VAT)?
2. Explain the procedure of computation of VAT liability of a dealer.
3. Explain the audit procedure applicable under the VAT system.
4. How is the value added tax (VAT) structure an improvement over the sales tax system?
5. "Input tax credit is generally given for the entire VAT paid within the State on purchases of taxable goods meant for re-sale or manufacture of taxable goods." Explain.
6. Discuss the provisions of registration under VAT.
7. How would you take input tax credit when goods purchased are transferred by the dealer to his branch in any other State?
8. "A registered dealer can set-off the amount of input tax against the amount of his output tax." Explain.
9. Explain the procedure of registration under 'value added tax' (VAT).
10. In what purchases input tax credit is not allowed under VAT?
11. What are the deficiencies in the design of VAT that has been adopted by the States in India? Give your opinion.
12. "Tax credit or invoice method has been adopted universally because of the inherent advantages in the credit method of calculating tax liability." Explain.
13. Who is liable to pay VAT? Discuss the advantages of introduction of VAT in India.
14. Discuss, with suitable example, various methods for computation of VAT liability.

PRACTICAL QUESTIONS

1. Pusha Traders have provided the following information relating to purchase and sales for the month of July, 2012 :

Purchases :

Product "A" total cost ₹1,80,000, rate of VAT 4%.

Product "B" total cost ₹2,60,500, rate of VAT 12.5%.

Sales :

Product "A" total sales ₹2,40,000, rate of VAT 4%.

Product "B" total sales ₹2,10,000, rate of VAT 12.5%.

On the basis of above information, compute eligible input tax credit and value added tax payable for the month.

2. Suresh, a trader sells entire raw material to a manufacturer of finished products in the same State. He buys his stock in trade from other States as well as from the local markets. Following transactions took place during the financial year 2012-13 :

Cost of materials purchased from other States including central sales tax @2% ₹3,06,000

Cost of local materials including VAT ₹6,75,000

Other expenditure includes storage, transport, interest, loading and unloading and profit earned by him ₹2,62,500

Calculate VAT and invoice value charged by him to the manufacturer. Assume the rate of VAT @ 12.50%.

ANSWERS/HINTS**True and False**

- (1) False; (2) True; (3) False; (4) True; (5) False; (6) False; (7) True; (8) True; (9) True

Practical Questions

- (1) Input Tax Credit – ₹ 3,913 / Tax Payable – Nil (2) VAT Payable – ₹ 71,063 / Invoice Value – ₹ 13,14,563.

Test Your Knowledge

1. (a); 2. (c); 3. (a); 4. (d); 5. (a) and 6. (a), (b) & (d)

SUGGESTED READINGS

- | | | |
|--------------------------------|---|---|
| 1. Dr. V.K. Singhania | : | Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi. |
| 2. Girish Ahuja and Ravi Gupta | : | Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi. |

Lesson 20

VAT provisions in India and VAT System in other Countries and Scope for Company Secretaries

LESSON OUTLINE

- The VAT system
- Some of the states in which VAT is implemented
- Role and Position of Company Secretaries
- Authorized representative before vat authorities:
- Certification for professionals
- Filing of returns:
- Scrutiny of records and advising to clients
- Vat audit
- VAT in other Countries
 - Australia
 - Canada
 - The European Union
 - France
 - Germany
 - United States
- Lesson Round Up
- Self Test Questions

LEARNING OBJECTIVES

In this chapter the VAT provisions in different countries and corresponding practices in GST Scheme or VAT Scheme has been adequately covered. It has been observed that the standard practice in the developed countries relating to Sales Tax is to follow the GST Scheme. The practice depends upon the peculiarities of individual countries or trade blocks as well as the International Trading System of goods and services. The Chapter also covers the poignant role, the Company Secretaries play in their professional capacity before any VAT authorities in our country. As a matter of fact, it is also being observed that the acceptability of company secretaries before the VAT authorities is increasing day by day.

At the end of this lesson, you will –

- Have a brief overview of state level VAT
- Know the role of Company Secretaries in VAT
- Understand the implementation of VAT worldwide.

The VAT was first introduced at a national level in France in 1954. Its original coverage was limited, and France did not move to a full VAT that reached the broader retail sector until 1968. The second phase of VAT adoption occurred from the late 1980s with the introduction of VAT in some high-profile industrialized countries outside the EU, such as Australia, Canada, Japan, and Switzerland. This phase also witnessed the massive expansion of VAT in transitional and developing economies, most notably in Africa and Asia. In the early 20th century, the VAT has been adopted by more than 140 countries and accounts for approximately 20 percent of worldwide tax revenue.

– *Exploring the Origins and Global Rise of VAT*

By Kathryn James

THE VAT SYSTEM

The VAT system is increasingly applied by different states of our country as an alternative to the existing Sales Tax System. The Empowered Committee on VAT under the Chairmanship of Dr. Ashim Kumar Dasgupta justified the implementation of VAT System in our country. The development of Vat System in our country is not according to the expectation of the Empowered Committee. Initially there is some apprehension in some states of the danger of losing revenue to other states, if VAT is implemented. As a result the development of VAT system has taken more time than it is reasonably required for. As of now, all states and union territories, adopted the VAT regime.

LEGISLATIVE PROVISIONS IN DIFFERENT STATES RELATING TO THE APPOINTMENT, JURISDICITON AND POWERS OF THE AUTHORITIES

ANDHRA PRADESH

Appointment, jurisdiction and powers of the authority

Under section 3A of the Andhra Pradesh Value Added Tax Act, 2005 the state government may appoint a Commissioner of Commercial Taxes and as many

- Commissioners of Commercial Taxes
- Joint Commissioners of Commercial Taxes
- Appellate Deputy Commissioners of Commercial Taxes
- Deputy Commissioners of Commercial Taxes
- Assistant Commissioners of Commercial Taxes
- Commercial Tax Officers and
- Deputy Commercial Tax Officers

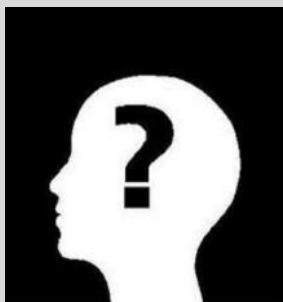
for the purpose of performing the functions respectively conferred on them by or under the Act.

The State Government under Section 3 of the above Act shall appoint an Appellate Tribunal consisting of the Chairman and two other members. To exercise the functions conferred on the Appellate Tribunal by or under the Act. The Chairman shall be the judicial officer not below the rank of a District Judge super time scale/district judge selection grade and of the other two members, one shall be the Officer of the State Government not below the rank of a Joint Commissioner of Commercial Taxes.

Under Section 28 of the Act The Deputy Commissioner shall have the powers of a Collector under the Andhra Pradesh Revenue Recovery Act, 1864 for the purpose of recovery of any amount due under the Act.

Any Officer of the Commercial Tax Department under Section 63 of the Act has the power to summon witnesses and production of documents. It has also the power to gather information under any proceedings.

Test Your Knowledge



1. Under Section 28 of the Act the _____ shall have the powers of a Collector under the Andhra Pradesh Revenue Recovery Act, 1864 for the purpose of recovery of any amount due under the Act.

- (a) Deputy Commissioner
- (b) Commercial Tax Officer
- (c) Deputy Commercial Tax Officers
- (d) Commissioners of Commercial Taxes

ARUNACHAL PRADESH**Appointment, jurisdiction and powers of the authority**

Under section 67(2) to assist the Commissioner in the administration of this Act-

- (a) the Government may appoint as many Additional Commissioners of Goods Tax as the government thinks necessary; and
- (b) the Commissioner may engage and procure the engagement of other persons to assist him in the performance of his duties (in this Act referred to as "Goods Tax Authorities").
- (c) the Commissioner and the Goods Tax authorities shall exercise such powers as may be conferred, and perform such duties as may be required, by or under this Act.

Under section 68(1) of the Arunachal Pradesh Value Added Tax Act the Commissioner shall have responsibility for the due and proper administration of the Act and shall have jurisdiction over the whole of Arunachal Pradesh.

Under section 69(1) the Commissioner may delegate any of his powers under this Act to any Goods Tax authorities, except the power conferred by this section.

ASSAM**Appointment, jurisdiction and powers of the authority**

Under section 3(2) of the Assam Value Added Tax, 2003, there shall be the following taxing authorities to assist the Commissioner :

- Additional Commissioner of Taxes
- Joint Commissioner of Taxes
- Deputy Commissioner of Taxes
- Assistant Commissioner of Taxes
- Superintendent of Taxes
- Inspector of Taxes.

The Commissioner shall perform his functions in respect of the whole of the state of Assam. The government may authorize an officer not below the rank of Deputy Commissioner of Taxes to exercise the power and perform the functions of the Appellate Authority.

Under section 42 of the above Act, where any court or the Tribunal passes an order in appeal or revision to the effect that any tax assessed under this Act or the Central Sales Tax Act, 1956.

Under Section 53 of the above Act where an order giving rise to refund is the subject matter of an appeal or further proceedings or where any other proceedings under this Act is pending.

Under the above Act Section 78, where in respect of any taxable goods, carried in a goods vehicle or held in stock by any dealer or on his behalf by any other person.

Under the above Act section 83, any authority including the Appellate Authority, Provisional Authority and Appellate Tribunal may, on an application or otherwise at any time within three years from the date of any order passed by it, rectify any error.

BIHAR**Appointment, jurisdiction and powers of the authority**

Under section 10 of the Bihar Value Added Tax Act, 2005, there shall be the following classes of authorities to be appointed by the State Government, for carrying out the purposes of this Act :

- Commissioner of Commercial Taxes;
- Senior Joint Commissioner of Commissioner of Taxes;
- Joint Commissioner of Commercial Taxes,
- Deputy Commissioner of Commercial Taxes,
- Assistant Commissioner of Commercial Taxes,
- Commercial Taxes Officer;
- Astt. Commercial Taxes Officer,

the authorities appoint under sub-section (1) shall, within such areas or in respect of such transactions falling within an areas as the state government may, by notification specify, exercise such powers as may be conferred and perform such duties as may be imposed, by or under this Act.

Under section 12 of the above Act the Tribunal constituted under section 9, or the Commissioner or any officer or authority appointed under section 10 or section 86 shall, for carrying out the purposes of this Act, have all the powers of a Civil Court under the Code of Civil Procedure, 1908.

Under section 71 of the above Act where an order giving rise to a refund is the subject-matter of an appeal or further proceeding or where any other proceeding under this Act is pending.

Under Section 78 of the Act The Commissioner may, after giving the parties a reasonable opportunity of being heard in the mater, by order in writing after recording is reason for so doing, transfer any proceedings or class of proceedings under any provisions of this Act.

CHATTISGARH

Appointment, jurisdiction and powers of the authority

Under section 3 of the Chhattisgarh Value Added Tax Act, 2005, there may be appointed a person to be the Commissioner of [Commercial Tax] and the following category of officers to assist him namely :

- Additional Commissioner of [Commercial Tax];
- Deputy Commissioner of [Commercial Tax];
- Assistant Commissioner or Additional Assistant Commissioner of [Commercial Tax];
- [Commercial Tax] Officer or Additional [Commercial Tax] Officer;
- Assistant [Commercial Tax] Officer; and
- Inspector of [Commercial Tax].
- The Commissioner of [Commercial Tax] and
- The Additional Commissioner of [Commercial Tax]

shall be appointed by the State Government and the other officers referred to in sub-section (1) shall be appointed by the State Government or such other authority as it may direct. The Commissioner of [Commercial Tax] and the Additional Commissioner or [Commercial Tax] shall exercise all the powers and perform all the duties conferred or imposed on the Commissioner by or under this Act throughout the state and for this purpose any reference to the Commissioner in this Act, shall be construed as a reference to the Additional Commissioner of [Commercial Tax].

Under section 54 of the above Act , if Commissioner or the Appellate Deputy Commissioner or the [Tribunal], in the course of any proceedings under this Act is satisfied that dealer has concealed his turnover or the aggregate of purchases prices in respect of any goods or has furnished false particulars of his sales or purchases.

GOA

Appointment, jurisdiction and powers of the authority

Under section 13 of the Goa Value Added Tax Act, 2005, the Government by notification of official gazette may appoint an

- Commissioner,
- Asstt. Commissioner,
- Additional Commissioner etc.

Under section 13(7) of the above Act no person shall be entitled to call in question, in any proceeding, any jurisdiction including the territorial jurisdiction of any officer or person appointed under sub-section (2) after the expiry of 30 days from the date of receipt by such person any notice under this Act, issued by such officer or person. If within the period aforesaid a separate application in writing in the prescribed form raising an objection as to the jurisdiction of any such officer or person is made to him, the officer or person shall refer the question to the Commissioner who shall after giving the person raising the objection a reasonable opportunity of being heard, make an order determining the question.

Under section 16 of the above section the Tribunal and Commissioner interalia have the following powers of a Civil Court for the purpose of :

- (a) proof of facts by affidavit;
- (b) summoning and enforcing the attendance of any person, and examining him on oath or affirmation;
- (c) compelling the production of documents; and (issuing commissions for the examination of witnesses).

Under section 39 the Commissioner has revisional powers under any proceedings under the above Act.

Under section 41 of the section, Tribunal has the power to rectify any error apparent of the record submitted by the assessee.

GUJARAT

Appointment, jurisdiction and powers of the authority

Under section 16 of the Gujarat Value Added Tax Act, 2003, the State Government shall appoint Commissioner of Commercial Tax and specified number of

- Joint Commissioners,
- Dy. Commissioners,
- Asstt. Commissioners,
- Commercial Tax Officers; and

Other Officers to assist the Commissioner of Commercial Tax in discharging his functions.

Under section 17 of the above Act the commissioner has the power to transfer proceedings from one jurisdiction to another jurisdiction as per the circumstances.

Under Section 20 of the above Act the Tribunal and the Commissioner have the following powers of civil courts for the purpose of :

- (a) receiving of proof of facts on affidavit;
- (b) summoning and enforcing the attendance of any person, and examining him on oath or affirmation;

- (c) compelling the production of documents; and
- (d) issuing commissions for the examination of witnesses.

In case of any affidavit to be made for the purposes of this Act, any officer appointed by the Tribunal or the Commissioner may administer the oath to the deponent.

Test Your Knowledge



- 2. Under which of the following sections of the Gujarat Value Added Tax Act, 2003, does the commissioner have the power to transfer proceedings from one jurisdiction to another as per the circumstances?**
- (a) Section 20
 - (b) Section 16
 - (c) Section 17
 - (d) Section 53

HARYANA

Appointment, jurisdiction and powers of the authority

Under section 55 of the Haryana Value Added Tax Act, 2003, the State Government may appoint a Commissioner and specified number of;

- Additional Excise and Taxation Commissioners,
- Joint Excise and Taxation Commissioners;
- Excise and Tax Officers;
- Asstt. Excise and Tax Officers and

Other Officers to assist the commissioner for discharging his duties under this Act. The Commissioner shall have jurisdiction over the whole of the state and shall exercise all the powers conferred and perform all the duties imposed on the Commissioner, by or under this Act, and other offices appointed shall exercise such powers as may be conferred and perform such duties as may be required by or under this Act in the area of jurisdiction as may from time to time be assigned to them.

Under section 46 of the Act the taxing authority and appellate authority has the same powers enjoyed by civil court.

Under section 47 of the Act such authorities can determine any person to be a dealer.

Under section 48 of the Act the authority has power to call the information from any person or company.

Under section 49 of the Act the same authority has the power to purchase under-priced goods.

Under section 50 the taxing authority has the power of transferring proceedings from one jurisdiction to another.

HIMACHAL PRADESH

Appointment, jurisdiction and powers of the authority

Under section 3 of the Himachal Pradesh Value Added Tax Act, 2005, the State Government may, by notification, appoint a person to be the Commissioner and such other persons with such designations, as it thinks fit, State

Government may by notification, appoint as many Assessing authorities as it may think fit. The commissioner and other persons appointed under sub-section (1) shall perform such functions and duties as may be required by or under this Act or as may be conferred, by the State Government by notification. The jurisdiction of the Commissioner and other officers posted at the State Headquarters shall extend to the whole of the state of Himachal Pradesh and the jurisdiction of other officers or officials shall, unless the State Government otherwise directs by notification extend to the districts or the areas of the districts for which they are for the time being posted.

Under section 33 of the Act any Asstt. Excise and Taxation Commissioner or Excise and Taxation Officer appointed to assist the Commissioner under sub-section (1) of section 3 or an Excise and Taxation Officer duly authorized by the Commissioner.

Under section 37 of the Act The Commissioner has power to call for information from Banking companies.

KARNATAKA

Appointment, jurisdiction and powers of the authority

Under section 58 of the Karnataka Value Added Tax Act, 2003, the State Government may appoint

- a Commissioner of Commercial Taxes and
- as may Additional, Joint, Deputy, Assistant Commissioners,
- State Representatives and

Commercial Tax Officers, as they think for the purpose of performing the functions. The Commissioner may empower an officer not below the rank of an Asstt. Commissioner or an Advocate or a Chartered Accountant [or a Cost Accountant] or a Tax Practitioner.

Under section 41 of the Act. The Commissioner has power of rectification of assessment or re-assessment in certain cases.

Under section 51 of the Act The Commissioner has power to withhold refund in certain cases.

KERALA

Appointment, jurisdiction and powers of the authority

Under section 3 of the Kerala Value Added Tax Act, 2003, the Commissioner shall have and exercise all the powers and shall perform all the duties conferred or imposed upon him by or under this Act. The Commissioner shall have Superintendence over all Officers and persons employed in the execution of this Act.

The Government shall appoint as many as Joint, Deputy Commissioners, Deputy Commissioners (Appeals), Asstt. Commissioner, Commercial Tax Officers and other officers.

The Government shall appoint an Appellate Tribunal consisting of a Chairman and as many other members. The Chairman shall be a person who is or has been a Judicial Officer not below the rank of a District Judge.

Under section 58 of the Act the Commissioner have powers of revision of the Commissioner suo motu.

Under section 66 of the Act the Commissioner has power to rectify any error apparent on the face of the record.

MADHYA PRADESH

Appointment, jurisdiction and powers of the authority

Under section 3 of the Madhya Pradesh Value Added Tax Act, 2002, the Taxing Authorities appointed a person to be:

- the Commissioner of Commercial Tax,
- Additional Commissioner of Commercial Tax;
- Deputy Commissioner or Additional Deputy Commissioner of Commercial Tax;
- Asstt. Commissioner or Additional Deputy Commissioner of Commercial Tax;
- Commercial Tax Officer or Additional Commercial Tax Officer,
- Inspector of Commercial Tax.

The Commissioner of Commercial Tax and the Additional Commissioner of Commercial Tax shall be appointed by the State Government and the other officers.

The Commissioner of Commercial Tax and the Additional Commissioner of commercial Tax shall exercise all the powers and perform all the duties conferred or imposed on the Commissioner by or under this Act. The state Government may, by order appoint any officer not below the rank of Deputy Commisioner, of commercial tax as Appellate Authority.

Under section 43 of the Act power of Commissioner and his assistants to take evidence on oath, etc.

Under Section 44 of the Act power of Commissioner to call for information in certain cases.

Under Section 45 of the Act, power of Commissioner to stay proceedings.

MAHARASHTRA

Appointment, jurisdiction and powers of the authority

Under section 10 of the Maharashtra Value Added Tax Act, 2002, the State Sales Tax Authorities shall appoint an Officer to be called:

- the Commissioner of Sales Tax,
- Additional Commissioners of Sales Tax,
- Joint Commissioners,
- Sr. Deputy Commissioners,
- Deputy Commissioners,
- Assistant Commissioners,
- Sales Tax Officers and other officers and persons.

The Commissioner/All Officers other shall have jurisdiction over the whole of the State. The Commissioner shall have and exercise all the powers and perform all the duties. A Joint Commissioner shall save as otherwise directed by the Commissioner. Sr. Dy. Commissioners, Dy. Commissioners, Asstt. Commissioners, Sales Tax Officers, other officers and persons shall within their jurisdiction exercise such of the powers and perform such of the duties of the Commissioner under this Act.

Under Section 14 powers of Tribunal and Commissioner, the Tribunal and the Commissioner shall have all the powers of a Civil Court for this purpose.

Under Section 54 of the Act power to withhold refund in certain cases.

Under section 70 of the Act the Commissioner have Power to collect statistics

ORISSA

Appointment, jurisdiction and powers of the authority

Under section 3 of the Orissa Value Added Tax Act, 2004, the State Government shall for purposes of this Act, appoint a person to

- the Commissioner of Sales Tax,
- Special Commissioner,
- an Additional Commissioner,
- Joint Commissioner,
- a Deputy Commissioner,
- an Assistant Commissioner,
- a Sales tax Officer or
- an Assistant Sales Tax Officer

to assist the Commissioner. The Commissioner shall have jurisdiction over the whole of the State and the other persons appointed within such areas as the Commissioner may.

Under section 6 of the act the Commissioner have power to transfer proceedings.

Under section 60 of the act the Commissioner have power to withhold refund in certain cases.

PUNJAB

Appointment, jurisdiction and powers of the authority

Under section 4 of the Punjab Value Added Tax Act, 2005, the State Government by Notification in Official Gazette constitutes the tribunal to exercise the powers and discharge functions stated under the above act.

The tribunal consists of a Chairman, and three members appointed by the State Government. The Chairman shall be either retire judge of the High Court or a retired or serving officer of the Rank of Chief Secretary to the state Government or Secretary to Government of India.

Under section 41 of the Act The commissioner have power to withhold round in certain cases.

Under section 87 of the Act The Commissioner have power to summon witness and production of records and power to seek assistance from police officer or other officer.

TAMILNADU

Appointment, jurisdiction and powers of the authority

Under section 55 of the Tamilnadu Value Added Tax Act, 2006, the State Government may appoint

- A Commissioner of Commercial taxes and as many
- Joint Commissioner of Commercial taxes,
- Appellate Deputy Commissioner of Commercial taxes,
- Deputy Commissioner of Commercial taxes,
- Appellate Assistant Commissioner of Commercial taxes,
- Territorial Assistant Commissioner of Commercial taxes,
- Administrative Assistant Commissioner of Commercial taxes,

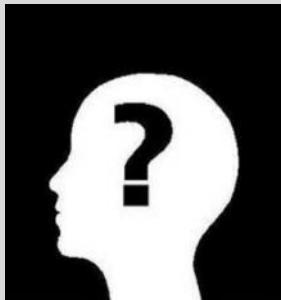
- Assistant Commissioner of Commercial taxes (Assessment),
- Assistant Commissioner of Commercial taxes (Enforcement), and
- Commercial Tax Officers and other officers shall perform the function.

Under Section 54 State has power of revision of Deputy Commissioner.

Under section 56 of the Act the Chairman of the Appellate Tribunal has power to transfer appeals.

Under section 65 authority has power to order production of accounts and powers of entry, inspection, etc. and also powers to inspect goods delivered to a carrier or a bailee.

Test Your Knowledge



3. Under which of the following sections of the Tamilnadu Value Added Tax Act, 2006 Chairman of the Appellate Tribunal has power to transfer appeals.

- (a) Section 56
- (b) Section 55
- (c) Section 54
- (d) Section 53

UTTAR PRADESH

Appointment, jurisdiction and powers of the authority

Under section 55 of the Uttar Pradesh Value Added Tax Act, 2007, the State Government may appoint different dates in respect of different provisions.

Under section 39 of the act the State Government has power to grant installment.

Under section 45 of the Act state government has power to order production of accounts documents and power of entry, inspection, audit.

Under section 46 the authority has power of search, inspection and seizure in case of a person other than dealer.

Under Section 47 of the Act the assessing authority has power to seek information and to issue summons.

Under section 48 of the Act an officer authorized under sub-section (1) of section 45 shall have the powers to seize any goods.

Under section 53 of the Act an officer exercising powers under the provisions of sections 45, 48, 50, 51 or 52 may take the assistance of police or other officers or officials of the state.

Under section 70 of the Act the State Government may make rules to carry out the purposes of this Act.

WEST BENGAL

Appointment, jurisdiction and powers of the authority

Under section 9 of the West Bengal Value Added Tax Act, 2003, all persons appointed under this Act to exercise any power or to perform any function there under shall be deemed to be public servants within the meaning of section 21 of the Indian Penal Code, 1860 (45 of 1860).

Under section 19 of the Act the State Government may by notification, fix the rate of tax, with prospective or retrospective effect.

Under section 21 of the Act the state government after giving by notification not less than 14 days' notice of its intention so to do, may by like notification with prospective or retrospective effect.

Under section 72 of the Act the authority has power of the Commissioner to stop delivery of goods and seizure of such goods.

Under section 88B of the Act the Commissioner has power to revise orders prejudicial to revenue.

Under section 91 of the Act the Appellate and Revisional Board, the Commissioner, the Special commissioner, the Additional Commissioner, or any person appointed under sub-section (1) of section 6 to assist the Commissioner, shall for the purposes of this Act, have the same powers as are vested in a court under the Code of Civil Procedure, 1908 (5 of 1908). Under sections 111, 112 the Commissioner has power to collect statistics from dealer and power of State Government to prescribe rates of fees and power of State Government to engage any person, firm or company to collect certain information's and also power of state government to make rules.

Test Your Knowledge



4. The VAT system is applied by different States in India as an alternative to the Central Sales Tax System.

- True
- False

ROLE AND POSITION OF COMPANY SECRETARIES

As we know that the VAT system in India is not unique and every state and Union Territories have its own VAT Act or Rules; it becomes quite a difficult task to give a generalized picture regarding Certification of Documents by professionals applicable to all states or union territories. However, considering the above situation, in general terms a professional including a Company Secretary, has to see that all documents to be filed before VAT authorities are correct or not. Specially the calculation sheet, tax calculation sheet, TIN or GRN No., etc. Apart from this the Company Secretary has to see the returns to be filed before VAT authorities are made in prescribed rules. He is also taken into consideration the procedural aspects regarding payment of VAT and related assessment proceedings.

As a professional he has to see that whether the dealer has maintained the records and documents required under the Act. He has to advice the concerned client the provisions relating to appeals and revisions if any matter relating to VAT proceedings is undertaken by Appellate Tribunal or Court of Law as the case may be. Company Secretary has also be well versed with the technical aspects in dealing with seizure and confiscation procedure before judicial or quasi judicial bodies. Besides this a professional dealing with VAT authorities has to carefully vouch and take careful steps with regard to books of accounts, and return procedures annually.

Every state has its own peculiarities regarding to documents to be filed before the VAT authorities in connection with filing of return and other related issues. The technicalities and calculation of tax is an important component of services is to be provided by professional under VAT authorities in India. Any mistakes or errors can put the client in great displeasure and anxiety.

The profession of Practicing Company Secretaries, which made a humble beginning in the sixties, has now reached greater heights. With the blended knowledge of various laws, the Practicing Company Secretaries are versatile professionals capable of rendering wide range of services in diversified fields including VAT.

(1) AUTHORIZED REPRESENTATIVE BEFORE VAT AUTHORITIES

The Company Secretaries play poignant role in their professional capacity before VAT authorities in our country. The acceptability of company secretaries before the VAT authorities is increasing day by day. Company Secretaries in Practice have now been recognized to act as an authorized representative for the purpose of appearing before VAT authorities under Statutes of various States. The Company Secretaries in Practice have been recognized to act as Authorized Representative under -

- (i) West Bengal Value Added Tax Rules, 2005 – Rule 2(1)(a)(iv)
- (ii) Bihar VAT Act, 2005 – Section 87(d)
- (iii) Goa VAT Act, 2005 – Section 82(1)(b)
- (iv) Karnataka VAT Rules, 2005 – Rule 168(1)
- (v) Kerala VAT Act, 2003 – Section 86(e)
- (vi) Daman & Diu VAT Regulation, 2005 – Regulation 82(1)(b)
- (vii) Jharkhand VAT Rules, 2006 – Rule 51(1)(c)
- (viii) Delhi Value Added Tax Act, 2004 – Section 82(1)(b)

The Company Secretaries in Practice have been recognized to act as Authorized Representative under the VAT Laws of the other states also via Section 288 of the Income Tax Act, 1961 read with Rule 50 of the Income Tax Rules, 1962.

(2) CERTIFICATION OF DOCUMENTS

Moreover, the VAT system in India is not unique and every state and Union Territories have its own VAT Act or Rules; it becomes quite a difficult task to give a generalized picture regarding Certification of Documents by professionals applicable to all states or union territories. A professional including a Company Secretary, has to see that all documents to be filed before VAT authorities, specially the calculation sheet, tax calculation sheet, TIN or GRN No., etc.

(3) FILING OF RETURNS

The Company Secretary has to see the returns to be filed before VAT authorities are made in prescribed rules. He should also consider the procedural aspects regarding payment of VAT and related assessment proceedings. Every state has its own peculiarities regarding the documents to be filed before the VAT authorities in connection with filing of return and other related issues.

(4) SCRUTINY OF RECORDS AND ADVISING TO CLIENTS

As a professional he has to see that whether the dealer has maintained the records and documents required under the Act. He has to advise the concerned client the provisions relating to appeals and revisions if any , matters relating to VAT proceedings is undertaken by Appellate Tribunal or Court of Law as the case may be. Company Secretary has to be well versed with the technical aspects in dealing with seizure and confiscation procedure before judicial or quasi judicial bodies. Besides this a professional dealing with VAT authorities has to carefully vouch and take careful steps with regard to books of accounts, and return procedures annually. The technicalities and calculation of tax is an important component of services to be provided by professional under VAT authorities in India.

VAT AUDIT

The Company Secretaries in Practice have been recognized to conduct VAT Audit under the following States:

- (a) Jharkhand VAT Act, 2005 – section 2(i).
- (b) Karnataka VAT Rules, 2005 – As a Tax Practitioner under Rule 34(1)
- (c) Gujarat VAT Act, 2005 – As a Tax Practitioner under Rule 59(1)(a)

VAT IN OTHER COUNTRIES

VAT does not primarily link tax liability to residence. This means that also foreign companies can become liable for VAT in countries other than the country where they have their business establishment.

Transactions for the supply of goods or services are normally covered by a sales contract or sales conditions. If drawn carefully, these contracts or sales conditions will also contain tax clauses. Such clauses are governed by contract law, which means that their contents should be distinguished from the legal situation according to tax law.

In order to be sure that both parties, i.e., supplier and customer, are fully aware of the VAT (but also e.g., customs, excise, sales tax) treatment, it is recommendable to verify the tax clauses of the contract or sales conditions before the agreement is concluded.

Value Added Tax (VAT) is a type of sales tax. In some countries, including Australia, Canada, New Zealand and Singapore, this tax is known as “goods and services tax” or GST; and in Japan it is known as “consumption tax”. VAT is an indirect tax, in that the tax is collected from someone other than the person who actually bears the cost of the tax (namely the seller rather than the consumer). As VAT is intended as a tax on consumption, exports (which are, by definition, consumed abroad) are usually not subject to VAT or VAT is refunded.

VAT was first introduced in France in 1954. Worldwide more than 145 countries have adopted VAT. List of few countries that collect VAT include :Algeria, Argentina, Azerbaijan, Bangladesh, Belarus, Belgium, Brazil, Bulgaria, Cameroon, Chile, China, Colombia, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Guatemala, Guyana, Hungary, Iceland, India, Indonesia, Ireland, Israel, Italy, Latvia, Lebanon, Lithuania, Luxembourg, Malta, Mexico, Monaco, Montenegro, Morocco, Netherlands, Norway, Pakistan, Panama, Peru, Philippines, Poland, Portugal, Romania, Russia, Senegal, Serbia, Slovakia, Slovenia, South Africa, South Korea, Spain, Sweden, Taiwan, Thailand, Tunisia, Turkey, Ukraine, United Kingdom, Uruguay, Uzbekistan, Venezuela, Vietnam, Zambia.

AUSTRALIA

The alleged high administrative and compliance costs associated with the VAT, relatively larger scope for tax evasion compared to retail sales tax, overstated claims for tax credit as a potential loophole and concerns expressed by trade unions regarding regressivity of the VAT have been cited as some of the reasons for Australia's deciding against the VAT. However, according to some others, the real reason against introduction of the VAT in Australia has been the far greater lead time required, of the order of an additional twelve months, for securing the approval of Parliaments compared to retail sales tax as it would be practically impossible to get any law passed through the Australian Parliament, which has a term of only three years.

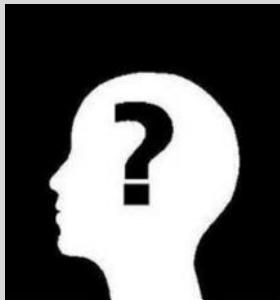
CANADA

There is federal VAT, the Goods and Services Tax (GST), that applies throughout the country. In one province, namely, Alberta, the GST is the only sales tax. In four provinces, namely, British Columbia, Saskatchewan, Manitoba, and Ontario, in addition to the GST, there is the only sales tax (GST) applied to the GST-exclusive tax base. In one province, Prince Edward Island, the provincial GST is applied to the GST-inclusive tax base, in three provinces, Newfoundland, Nova Scotia, and New Brunswick, there is a joint federal-provincial VAT, called the Harmonized Sales Tax (HST) and administered by the federal government at a uniform rate of 15 per cent.

THE EUROPEAN UNION

The value added tax was perceived by the member-countries of the European Union as the ideal means to "promote neutrality and uniformity of the tax burden and to provide incentives for increased productivity and industrialization. Though the EC Fiscal and Financial Committee had recommended as early as 1962 that all member-countries should shift to the VAT system, the change for the original members was completed only in 1973 when Italy switched over to the VAT. However, certain other recommendations of the committee regarding uniformity of rates and eventual adoption of the original principle for taxation of trade within the EC were not implemented immediately.

Test Your Knowledge



5. Which of the tax is applicable in the province of Alberta in Canada?

- (a) Goods and Services Tax (GST)
- (b) Only Sales Tax (GST)
- (c) Harmonized Sales Tax (HST)
- (d) Value Added Tax (VAT)

FRANCE

The Value Added Tax (VAT) had its origin only in France. The latest innovation is the value-added tax. Its emergence in France illustrates the process by which a sort of continuing ferment of improvisation now and then gives rise to an invention of the first order. They were the first Europeans to adopt it in 1954. A new regulation was introduced in France regarding VAT transaction. Since September 1st, 2006 according to Article 283-1 of the FTC when a supply of goods or services is carried out by a French VAT liable entity non-established in France, VAT must be self-assessed by the buyer when he is VAT identified in France. VAT registration is mandatory for intra-EU operations. When the supplier is not established in E.O., the Respondent is necessarily get its Fiscal Representative nominated through application under Article 289A of French Tax Code (FTC).

GERMANY

On January 1, 1968, Germany replaced its multi-point sales tax on goods and services, which extended down to the retail stage, by a VAT with a normal rate of 10 per cent and a reduced rate of 5 per cent on foodstuffs and agricultural products like raw wool raw hides, and timber. The switchover to the VAT was meant to be revenue-neutral and was not expected to have any tangible effect on prices.

UNITED KINGDOM

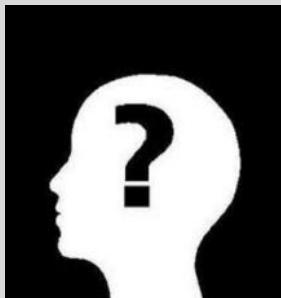
The VAT was introduced in the United Kingdom on 1 April, 1973. As in Spain, this was in fulfillment of one of the key conditions for entry into the European Community. It is destination-based, general consumer expenditure tax chargeable on all supplies of goods and services in the country, barring those which are exempted or zero-rated. The tax is expected to be borne by the final consumer, though collected at each stage of production/trade. The VAT replaced two of the major indirect taxes levied in the UK earlier, viz., the Purchase Tax (PT) on commodities and the Selective Employment Tax (SET). The PT was a single stage tax on wholesalers that had to make a distinction which was often difficult to draw between goods and services and between different categories of dealers and goods. The purchase tax was then chargeable at three different rates—25 per cent, 18 per cent and 11.15 per cent and these rates represented substantial reductions from previous levels in preparation for the introduction of the VAT on the wholesale values of many goods. The SET was a tax essentially on selected

services. The Government felt that these taxes were inferior to a tax on the value added that could be applied to consumer expenditures comprehensively. On several counts, the VAT clearly offered a better instrument of taxation. Then there was the EC requirement. It should, however, be noted that UK would have gone in for the VAT in any case because of its intrinsic merits.

UNITED STATES

The United States, with a federal structure, provides an important case study for consideration of the VAT for any federal economy in general. Even though the United States has been interested in the VAT for the last thirty years, its actual introduction in the US does not seem to be anywhere near the horizon. The main reason for this situation is that the United States does not merely appear to be satisfied with its existing states retail sales taxes but the possibility of the federal government usurping the states' powers of sales taxation has been keeping it away from the VAT at a respectable distance. Although attempts for a federal level VAT date as far back as the proposal by T.S. Adams in 1921, it was in 1972 that the VAT was recommended as a source of revenue for providing relief on residential property taxes. The proposed Tax Restructuring multiple rates between 10 and 15 per cent. In the late seventies, Congressman Ulman came up with a proposal for the VAT to replace part of the pay roll tax, personal income tax and corporate income tax for \$50 billion and \$28 billion respectively. This proposal was subjected to a great deal of public debate even after 1980 when Ulman lost his election.

Test Your Knowledge



6. Which of the following indirect taxes were replaced by VAT in UK?

- (a) Purchase Tax (PT)
- (b) Selective Employment Tax (SET)
- (c) Harmonized Sales Tax (HST)
- (d) Goods and Services Tax (GST)

LESSON ROUND UP

- All states and union territories, adopted the VAT regime. Moreover, the VAT system in India is not unique and every state and Union Territories have its own VAT Act or Rules;
- The Company Secretaries play a significant role in their professional capacity before VAT authorities in our country. The acceptability of company secretaries before the VAT authorities is increasing day by day. Company Secretaries in Practice have now been recognized to act as an authorized representative for the purpose of appearing before VAT authorities under Statutes of various States.
- The Company Secretaries in Practice have also been recognized to conduct VAT Audit.
- VAT was first introduced in France in 1954. Worldwide more than 145 countries have adopted VAT.

SELF TEST QUESTIONS

These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation.

ELABORATIVE

1. Discuss the role of Company Secretaries in the professional capacity before VAT authorities in our country.

2. Explain briefly the practices followed in developed countries with regard to goods and services tax.
 3. How the practice followed specially in Western Countries is different from practices followed in our country under VAT regime.
 4. Discuss briefly the powers of the VAT authorities of Andhra Pradesh, Haryana and Maharashtra.
 5. Explain briefly the procedures relating to the appointment of Chairman and other officers under VAT regime in the states of West Bengal, Gujarat and Tamilnadu.

Test Your Knowledge

- 1. (a); 2. (c); 3. (a); 4. True; 5. (a); 6. (a) and (b)**

SUGGESTED READINGS

1. Dr. V. K. Singhania : Students Guide to Income-tax; Taxmann Publications Pvt. Ltd., New Delhi.

2. Girish Ahuja and Ravi Gupta : Systematic Approach to Income-tax and Sales-tax; Bharat Law House, New Delhi.

**EXECUTIVE PROGRAMME
TAX LAWS AND PRACTICE**

EP-TL&P

TEST PAPERS

A Guide to CS Students

To enable the students in achieving their goal to become successful professionals, Institute has prepared a booklet 'A Guide to CS Students' providing the subject specific guidance on different papers and subjects contained in the ICSI curriculum. The booklet is available on ICSI website and students may download from <http://www.icsi.edu/Portals/0/AGUIDETOCSSTUDENTS.pdf>

WARNING

It is brought to the notice of all students that use of any malpractice in Examination is misconduct as provided in the explanation to Regulation 27 and accordingly the registration of such students is liable to be cancelled or terminated. The text of regulation 27 is reproduced below for information:

"27. Suspension and cancellation of examination results or registration.

In the event of any misconduct by a registered student or a candidate enrolled for any examination conducted by the Institute, the Council or the Committee concerned may suo motu or on receipt of a complaint, if it is satisfied that, the misconduct is proved after such investigation as it may deem necessary and after giving such student or candidate an opportunity to state his case, suspend or debar the person from appearing in any one or more examinations, cancel his examination result, or studentship registration, or debar him from future registration as a student, as the case may be.

Explanation – Misconduct for the purpose of this regulation shall mean and include behaviour in a disorderly manner in relation to the Institute or in or near an Examination premises/centre, breach of any regulation, condition, guideline or direction laid down by the Institute, malpractices with regard to postal or oral tuition or resorting to or attempting to resort to unfair means in connection with the writing of any examination conducted by the Institute".

**EXECUTIVE PROGRAMME
TAX LAWS AND PRACTICE
PRACTICE TEST PAPER**

(This test paper is for practice and self study only and not to be sent to the institute)

Time allowed: 3 hours

Maximum mark: 100

[Attempt all questions. Each question carries 1 mark. There is no negative mark for incorrect answers.]

PART A

1. A person includes:
 - a) Only Individual
 - b) Only Individual and HUF
 - c) Individuals, HUF, Firm, Company only
 - d) Individuals, HUF, Company, Firm, AOP or BOI, Local Authority, Every Artificial Juridical Person
2. Every assessee is a person, and
 - a) every person is also an assessee
 - b) every person need not be an assessee
 - c) an individual is always an assessee
 - d) A HUF is always an assessee
3. Describe the status of the following person (i.e. individual, HUF, Firm, Company etc.) X and Y are legal heirs of Z. Z died in 2014 and X and Y carry on his business without entering into a partnership.
 - a) Firm
 - b) Limited Liability Partnership
 - c) Company
 - d) Body of Individual
4. Assessment year can be a period of:
 - a) only more than 12 months
 - b) 12 months and less than 12 months
 - c) only 12 months
 - d) 12 months and more than 12 months
5. Year in which income is taxable is known as..... and year in which income is earned is known as.....
 - a) Previous year, Assessment year
 - b) Assessment year, Previous year
 - c) Assessment year, Assessment year
 - d) Previous year, Previous year

6. All assessees are required to follow:
- Uniform previous year which must be calendar year only
 - Uniform previous year which must be financial year only
 - Any period of 12 months
 - Period starting from 1st July to 30th June only
7. First previous year in case of a business/profession newly set up on 31.3.2014 would:
- Start from 1st April, 2013 and end on 31st March, 2014
 - Start from 31st March, 2014 and will end on 31st March, 2014
 - Start from 1st January, 2014 and end on 31st December, 2014
 - Start from 1st January, 2014 and will end on 31st March, 2014
8. A person follows Calendar year for accounting. For taxation, he has to follow:
- Calendar year only - 1st January to 31st December
 - Financial year only - 1st April to 31st March
 - Any of the Calendar or Financial year as per his choice
 - He will follow extended year from 1st January to next 31st March (a period of 15 months)
9. In which of the following cases, income of previous year is assessable in the previous year itself:
- Assessment of persons leaving India
 - A person in employment in India
 - A person who is into illegal business
 - A person who is running a charitable institution
10. In which of the following cases, Assessing Officer has the discretion to assess the income of previous year in previous year itself or in the subsequent assessment year:
- Shipping business of non-residents
 - Assessment of Association of Persons or Body of Individuals formed for a particular event or purpose
 - Assessment of persons likely to transfer property to avoid tax
 - Discontinued business
11. In case of a female individual, who is of 59 years of age, what is the maximum exemption limit for AY 2014-15:
- Rs. 2,00,000
 - Rs. 2,50,000
 - Rs. 5,00,000
 - Nil
12. Calculate Income-tax payable by an Individual (aged 30 years) for AY 2014-15 if his total income is Rs. 1,01,20,000:
- Rs. 30,38,500

- b) Rs. 32,47,180
 - c) Rs. 29,14,900
 - d) Rs. 29,50,000
13. Calculate the amount of rebate under section 87A in case of a resident individual having total income of Rs. 3,00,000.
- a) Rs. 30,000
 - b) Rs. 10,000
 - c) Rs. 2,000
 - d) Rs. 5,000
14. Out of the following, which of the capital receipt is not taxable:
- a) Capital gains of Rs. 10,00,000
 - b) Amount of Rs. 5,00,000 won by way of lottery, games, puzzles
 - c) Amount of Rs. 2,00,000 received by way of gift from relatives
 - d) Amount of Rs. 1,00,000 received by way of gift from a friend on marriage anniversary
15. Total income is to be rounded off to nearest multiple of..... and tax is to be rounded off to nearest multiple of
- a) Ten, Rupee
 - b) Hundred, Ten
 - c) Ten, Ten
 - d) Rupee, Rupee
16. Income accrued outside India and received outside India is taxable in case of:
- a) Resident and ordinary resident (ROR) only
 - b) Resident but not ordinary resident (RNOR) only
 - c) Non resident only
 - d) ROR, RNOR and Non-Resident
17. An Indian company would:
- a) be resident in India if its control and management is wholly situated in India
 - b) be resident in India if its control and management is wholly or partly situated in India
 - c) be resident in India if its control and management is wholly situated outside India
 - d) be always resident in India irrespective of control and management
18. Determine the residential status of a HUF if HUF's control and management is wholly situated in India and Karta of HUF is a Non-resident in India for that previous year.
- a) Resident and Ordinary Resident (ROR)
 - b) Resident but not ordinary resident (RNOR)
 - c) Non-Resident (NR)
 - d) ROR or RNOR

19. Profits of Rs. 1,00,000 for the year 2012-13 of a business in Germany remitted to India during the previous year 2013-14 (not taxed earlier) would be:
- Taxable in India for ROR only
 - Not taxable in India for all (ROR, RNOR and NR)
 - Taxable in India for all (ROR, RNOR and NR)
 - Taxable only for RNOR and NR
20. Profits of Rs. 2,00,000 is earned from a business in USA which is controlled in India, half of the profits being received in India. How much amount is taxable in India for a Non-resident individual?
- Rs. 2,00,000
 - Nil
 - Rs. 1,00,000
 - Rs. 3,00,000
21. Dividend from British Co. of Rs. 2,00,000 received in London will be taxable in case of:
- Resident and ordinary resident (ROR) only
 - Not ordinary resident (NOR) only
 - Non resident (NR) only
 - ROR, NOR and NR all
22. Which out of the following income is exempt from tax?
- Sum received by a member from HUF
 - Dividend received from a foreign company
 - Agricultural income from Bangladesh
 - Salary Income from a Non Profitable Organisation
23. Which income out of the following is an exempt income for political party?
- Income from house property only
 - Income from other sources only
 - Income by way of voluntary contribution from any person only
 - Income from house property, income from other sources, income from capital gains and income by way of voluntary contribution
24. Dividend received by a shareholder from an Indian company is exempt. Interest or any other expenditure incurred for earning such dividend income shall:
- be allowed as deduction
 - not be allowed as deduction
 - be allowed as deduction subject to certain conditions
 - be allowed only if Assessing Officer is satisfied that it is only interest expenditure

25. Gross Total Income is arrived after:
- only adding Income under five heads of Income;
 - adding Income under five heads of Income excluding losses;
 - adding Income under five heads of Income, after applying clubbing provisions and making adjustment of set off and carry forward of losses
 - adding Income under five heads of Income, after applying clubbing provisions and making adjustment of set off and carry forward of losses and after allowing deduction under section 80C to 80U
26. Salary of S (Rs. 40,000 per month) becomes due on the last day of the month but is paid on 7th of next month. Also, salary of April, 2014 and May, 2014 is received in advance in March, 2014. What will be his gross income for Assessment Year 2014-15?
- Rs. 5,60,000
 - Rs. 4,80,000
 - Rs. 4,40,000
 - Rs. 5,20,000
27. Calculate the exempt HRA from the following details:
X is entitled to a basic salary of Rs. 50,000 p.m. and dearness allowance of Rs. 10,000 p.m., 40% of which forms part of retirement benefits. He is also entitled to HRA of Rs. 20,000 p.m. He actually lives with his parents in Mumbai and does not pay any rent. Market rent of that house is Rs. 20,000 p.m. in Mumbai.
- Nil
 - Rs. 1,75,200
 - Rs. 64,800
 - Rs. 2,40,000
28. Y received children education allowance of Rs. 500 p.m. for 10 of his children. Calculate taxable amount of children education allowance for the assessment year 2014-15 if entire Rs. 500 is spent by Y.
- Nil
 - Rs. 4,800
 - Rs. 6,000
 - Rs. 3,600
29. A Ltd. has advanced an interest free loan of Rs. 5,00,000 to B for purchase of car on 1.5.2013. B has been repaying the loan in instalments of Rs. 20,000 p.m. on the 1st of next month. Compute the value of perquisite on account of interest assuming the interest charged by SBI is 10% p.a.
- Rs. 34,833
 - Rs. 36,667
 - Rs. 40,000
 - Rs. 50,000
30. Employer provides a car (below 1.6 Ltr. capacity) alongwith a driver to X partly for official and partly for personal purpose. The expenses incurred by the company are:

- running and maintenance expenses - Rs. 32,000
driver's salary - Rs. 36,000
Taxable value of perquisite is:
a) Rs. 21,600
b) Rs. 10,800
c) Rs. 32,400
d) Rs. 39,600
31. X retired on 15.4.2013 from a company. He was entitled to a pension of Rs. 4,000 p.m. At the time of retirement, he got 75% of the pension commuted and received Rs. 1,20,000 as commuted pension. Compute the taxable portion of the commuted pension if he is entitled to gratuity.
a) Rs. 66,667
b) Rs. 53,333
c) Rs. 1,20,000
d) Rs. 78,667
32. Mr. A (65 years) submits the following information for the Assessment year 2014-15:
Gross salary - Rs. 8,80,000
Income from other sources - Rs. 60,000
Contribution to PPF- Rs. 70,000
Compute the tax liability of A.
a) Rs. 99,000
b) Rs. 97,000
c) Rs. 1,01,970
d) Rs. 99,970
33. Calculate the Gross Annual value from the following details:
Municipal Value - Rs. 45,000
Fair rental value - Rs. 50,000
Standard rent - Rs. 48,000
Actual Rent - Rs. 42,000
a) Rs. 50,000
b) Rs. 48,000
c) Rs. 45,000
d) Rs. 42,000
34. M took a loan of Rs. 6,00,000 on 1.4.2011 from a bank for construction of a house. The loan carries an interest @ 10% p.a. The construction is completed on 15.6.2013. The entire loan is still outstanding. Compute the interest allowable for the assessment year 2014-15.

- a) Rs. 60,000
 - b) Rs. 1,80,000
 - c) Rs. 84,000
 - d) Rs. 24,000
35. A had one self occupied house property in Mumbai for residence. Fair rent of that property is Rs. 56,000 per annum. Municipal valuation is Rs. 28,000. Municipal taxes paid are Rs. 5,000 including Rs. 1,000 for an earlier year. The house was constructed in December, 2005 with a loan of Rs. 12,00,000 from a bank taken in November, 2004. During the previous year 2013-14, the assessee refunded Rs. 2,30,000 which includes Rs. 1,68,000 as current year interest. Compute the income from house property for assessment year 2014-15?
- a) Loss of Rs. 30,000
 - b) Loss of Rs. 1,68,000
 - c) Nil
 - d) Loss of Rs. 1,50,000
36. Which out of the following is not a case of deemed ownership of house property?
- a) Transfer to a spouse for inadequate consideration
 - b) Transfer to a minor child for inadequate consideration
 - c) Holder of an imitable estate
 - d) Co-owner of a property
37. Which of the following income is not chargeable as income of business or profession?
- a) Profits and gains of business carried by an assessee during the previous year
 - b) Income derived by a trade, professional or similar association from specific services performed for its members
 - c) Income from the activity of owning and maintaining race horses
 - d) Salary received by a partner of a firm from the firm in which he is a partner
38. Income is chargeable as profits of the business, only if the business is carried on by the assessee at any time during the previous year. However, there are certain exceptions to the above rule. Which out of the following is not an exception:
- a) Recovery against bad debts
 - b) Sale of capital asset used for scientific research
 - c) Recovery against any loss, expenditure or trading liability earlier allowed as a deduction
 - d) Recovery against any loss, expenditure or trading liability earlier not allowed as a deduction
39. If a new machinery is purchased on 15.4.2013 and put to use for the purpose of the business on 28.12.2013, depreciation would be allowable at the rate of:
- a) 7.5%
 - b) 15%
 - c) 10%
 - d) 20%

40. Which of the following expenditure on scientific research is not allowed as deduction?
- Revenue expenses incurred during the previous year
 - Revenue expenses on payment of salary to employees engaged in scientific research and purchase of material used in scientific research incurred during three years immediately preceding the commencement of business
 - Capital expenditure incurred on scientific research during the year related to the business
 - Expenditure incurred on acquisition of land during the year for scientific research
41. Which out of the following is not a condition to be fulfilled for claiming expenditure under section 37(1)?
- Such expenditure should not be covered under the specific sections i.e. sections 30 to 36
 - Expenditure should be of capital nature
 - Expenditure should not be of a personal nature
 - Expenditure should have been incurred wholly or exclusively for the purpose of the business or profession.
42. Financial statement of A on 31.3.2014 reveals that the following expenses were due during year ended 31.3.2014 but have been paid after 31.3.2014:
- Employer's contribution to provident fund: Rs. 55,000 (Rs. 25,000 paid on 15.7.2014, Rs. 10,000 paid on 31.7.2014 and Rs. 20,000 paid on 15.1.2015)
- The due date of filing return is 31.7.2014. What would be the deduction for AY 2014-15?
- Rs. 55,000
 - Rs. 35,000
 - Rs. 10,000
 - Rs. 45,000
43. M owns the following commercial vehicles:
- 2 light commercial vehicles: one for 9 months and two days and the other for 12 months
 - 2 heavy good vehicle - one for 6 months and 25 days and the other for 11 months and 12 days.
 - 2 medium goods vehicles - one for 6 months and the other for 8 months and 15 days
- Compute the income from business of M if he opts for the scheme under section 44AE.
- Rs. 99,000
 - Rs. 95,000
 - Rs. 67,500
 - Rs. 2,61,500
44. Cost of Acquisition in case of bonus shares allotted before 1.4.1981 will be:
- Nil
 - Fair Market Value as on 1.4.1981
 - Rs. 10,000
 - Cost of Original shares on the basis of which bonus shares are allotted.

45. Indexation benefit on Cost of acquisition is available on the long term capital asset. However, in certain cases, indexation benefit is not available. In which of the following cases, indexation benefit is allowed?
- a) Debentures issued by a company
 - b) Self generated goodwill of a business
 - c) Bonus shares allotted on 1.4.2000
 - d) Jewellery
46. A owns a house property which was purchased by him on 1.5.1979 for Rs. 3,00,000. The said property was destroyed by fire on 3.4.2013 and A received a sum of Rs. 38,00,000 from the insurance company during the year. The market value of the above property as on 1.4.1981 was Rs. 4,00,000.
- Compute the capital gain for the assessment year 2014-15. (Cost Inflation Index for 1981-82 = 100 and 2013-14 = 939)
- a) Rs. 44,000
 - b) Rs. 34,00,000
 - c) Rs. 35,00,000
 - d) Rs. 9,83,000
47. M owns two machineries eligible for depreciation at the rate of 15%. The WDV of these machines as on 1.4.2013 was Rs. 25,000 and Rs. 40,000 respectively. No other asset was acquired in this block during the year. One of these machines were sold during the previous year for Rs. 75,000. Compute the capital gain.
- a) Short term capital gain of Rs. 10,000
 - b) Short term capital loss of Rs. 10,000
 - c) Long term capital gain of Rs. 10,000
 - d) No capital gain as depreciation would be allowed on one of the machines left with M.
48. For availing exemption under section 54, which amount is eligible for availing exemption?
- a) Purchase/Construction of a residential house property upto due date of return of income only
 - b) Deposit in capital gain account scheme upto due date of return of income only
 - c) Purchase/Construction of a residential house property upto due date of return of income and deposit in capital gain account scheme upto due date of return of income
 - d) Purchase / construction after three years from the transfer date
49. Which of the following is not an income taxable as income from other sources?
- a) family pension
 - b) Casual income
 - c) director's sitting fee for attending board meetings
 - d) Rent received for house property including use of plant and machinery, where rent is separable between rent for house property and rent for use of plant and machinery.
50. ABC Private Limited gives a loan of Rs. 5,00,000 to X, who is not a shareholder. X gives the amount as loan to A who is shareholder in ABC Private Limited holding 15% shares. In this case, amount taxable as deemed dividends in the hands of X will be.....and that in hands of A will be.....

- a) Nil, Nil
 - b) Nil, Rs. 5,00,000
 - c) Rs. 5,00,000, Nil
 - d) Rs. 5,00,000, Rs. 5,00,000
51. M's property was compulsorily acquired. He received enhanced compensation on 15.11.2013 which includes Rs. 2,30,000 as interest on such enhanced compensation. Compute the taxable amount of interest.
- a) Rs. 2,30,000
 - b) Nil
 - c) Rs. 1,15,000
 - d) Rs. 2,00,000
52. Transfer of income without transfer of asset would be taxable in the hands of:
- a) Transferor only
 - b) Transferee only
 - c) Either transferor or transferee
 - d) Both transferor and transferee
53. Income from asset transferred to spouse will be taxable in the hands of transferor if:
- a) asset has been transferred in pursuance of an agreement to live apart;
 - b) asset was transferred for an adequate consideration;
 - c) asset was transferred before marriage;
 - d) asset was transferred for inadequate consideration
54. Long term capital loss can be set off from which of the following:
- a) Short term capital gain only
 - b) Long term capital gain only
 - c) Income from business or profession
 - d) Income from salary
55. Loss from house property can be carried forward and set off in the subsequent 8 Assessment years:
- a) Only if return of loss is filed within due date
 - b) Even if return of loss is filed after due date
 - c) It does not matter when return is filed
 - d) Carry forward of loss from house property is not allowed at all.
56. Business loss of an amalgamating company shall be:
- a) carried forward and set off in the hands of amalgamated company unconditionally
 - b) carried forward and set off in the hands of amalgamated company subject to certain conditions
 - c) not be carried forward

- d) allowed to be carried forward only by amalgamating company
57. Deduction under section 80C to 80U cannot exceed:
- a) Gross Total Income
 - b) Total Income
 - c) Income from business or profession
 - d) Income from house property
58. Aggregate amount of deduction under section 80C, 80CCC and 80CCD cannot exceed:
- a) Rs. 1,10,000
 - b) Rs. 2,00,000
 - c) Rs. 1,00,000
 - d) Nil
59. A pays (through any mode other than cash) during the previous year medical insurance premia as under:
- (i) Rs. 18,000 to keep in force an insurance policy on his health and on the health of his wife and dependent children;
 - (ii) Rs. 18,000 to keep in force an insurance policy on the health of his parents where his father is a senior citizen.
- Calculate deduction under section 80D.
- a) Rs. 36,000
 - b) Rs. 33,000
 - c) Rs. 30,000
 - d) Rs. 15,000
60. Deduction in respect of contribution to political party will:
- a) be allowed in respect of sum paid by way of cash
 - b) not be allowed if payment made in cash
 - c) This type of deduction is not allowed whether payment is in cash or not.
 - d) be allowed if payment made in cash, subject to certain conditions
61. Amount of deduction in case of a person with severe disability under section 80U will be:
- a) Rs. 50,000
 - b) Rs. 75,000
 - c) Rs. 1,00,000
 - d) Rs. 1,50,000
62. Gross Total Income of A aged 31 years as computed under Income-tax Act for the AY 2014-15 is Rs. 2,50,000. He deposits Rs. 20,000 in a PPF account. Compute the tax payable by A assuming that he has agricultural income of Rs. 3,50,000.
- a) Rs. 4,120

- b) Rs. 3,090
 - c) Nil
 - d) Rs. 1,030
63. Due date of furnishing return of income for a working partner of a firm whose accounts are required to be audited is:
- a) 31st July of the assessment year
 - b) 30th September of the assessment year
 - c) 30th November of the assessment year
 - d) 31st March of the assessment year
64. Advance tax shall be payable during a financial year, only when the amount of such advance tax payable by the assessee during that year is:
- a) Rs. 10,000 or more
 - b) More than 0
 - c) Rs. 1,00,000 or more
 - d) Rs. 10,00,000 or more
65. An individual needs to pay Rs. 1,00,000 as advance tax. By 15th of December, how much amount must be paid by the individual:
- a) Rs. 30,000
 - b) Rs. 60,000
 - c) Rs. 1,00,000
 - d) Nil
66. As per Section 45, Wealth tax is not payable by certain persons. Which of the following is not mentioned under Section 45:
- a) Any company registered under section 25 of the Companies Act, 1956 (non profit making companies);
 - b) Any Political party
 - c) Reserve Bank of India
 - d) A public limited company
67. As per Section 2(ea), which of the following is an asset in case of an individual:
- a) Cash in hand upto Rs. 50,000
 - b) Shares
 - c) Debentures or Bonds
 - d) Motor car used for official purposes
68. In case marriage of minor's parents subsists, minor's wealth will be included in the wealth of the parent:
- a) Whose wealth excluding minor's wealth is greater;
 - b) Whose wealth excluding minor's wealth is lesser;

- c) Assessing officer to decide the parent
 - d) Father only
69. Money and assets brought into India by citizen of India or persons of Indian origin is exempt for:
- a) only relevant assessment year
 - b) 5 successive assessment year
 - c) 6 successive assessment year
 - d) 7 successive assessment year
70. Net Wealth is to be rounded off to nearest multiple ofand wealth tax is to be rounded off to nearest multiple of.....
- a) Rs. 100, Rs. 100
 - b) Rs. 100, Rs. 10
 - c) Rs. 100, Rs. 1
 - d) Rs. 10, Rs. 10

PART B

71. Service tax was introduced in India in the year:
- a) 1994
 - b) 2000
 - c) 2010
 - d) 2014
72. Service is applicable to:
- a) Whole of India excluding Jammu & Kashmir, Union Territories of Dadra, Nagar Haveli, Daman and Diu
 - b) Whole of India excluding Jammu & Kashmir
 - c) Whole of India
 - d) Whole of World
73. The provisions relating to service tax are given in:
- a) Finance Act, 1994 - Chapter V and VA
 - b) Income-tax Act, 1961
 - c) The Central Excise Act
 - d) The Service Tax Act
74. On recommendation of which of the following committee, service tax was introduced in India:
- a) Naresh chandra committee
 - b) Kelkar committee
 - c) Dr. Raja J Chelliah Committee
 - d) Justice Verma Committee

75. Service tax is administered by:

- a) Excise Department
- b) Income tax department
- c) Custom department
- d) Service tax department

76. Power to levy service tax is provided at present in the Constitution vide entry No.:

- a) 54 of the State List
- b) 84 of the Union List
- c) 92C of the Union List
- d) 97 of the Union List

77. India follows which the approach for levying service tax at present:

- a) Selective approach
- b) Comprehensive approach
- c) Hybrid approach
- d) As per the directions of Central Board of Excise & Customs (CBEC)

78. Service tax is not payable in the year of commencement of business if the aggregate value of invoices issued of taxable service does not exceed:

- a) Rs. 1,00,000
- b) Rs. 4,00,000
- c) Rs. 10,00,000
- d) Rs. 9,00,000

79. Service tax (inclusive of cess) rate at present is:

- a) 12%
- b) 12.36%
- c) 12.24%
- d) 10.3%

80. Service provider claiming exemption of Rs. 10,00,000 shall have to apply for registration where the aggregate value of service exceeds:

- a) Rs. 10,00,000
- b) Rs. 9,00,000
- c) Rs. 8,00,000
- d) Rs. 12,00,000

81. Penalty for non-registration is higher of the following:

- a) Rs. 10,000 or Rs. 100 per day of default

- b) Rs. 10,000 or Rs. 200 per day of default
 - c) Rs. 1,00,000 or Rs. 2,000 per day of default
 - d) Rs. 10,00,000 or Rs. 2,000 per day of default
82. Who can cancel the Registration Certificate?
- a) Assistant Commissioner of Income tax
 - b) Deputy Commissioner of Income tax
 - c) Superintendent of Central Excise
 - d) Commissioner of Central Excise
83. If the gross amount charged in the execution of a works contract is Rs. 2,00,000 and the value of the property in goods transferred in the execution of such works contract is Rs. 1,30,000. The value of taxable service in the execution of the works contract shall be:
- a) Rs. 2,00,000
 - b) Rs. 1,30,000
 - c) Rs. 70,000
 - d) Nil
84. A Ltd. receives taxable service from B Ltd. of USA on 28.8.2013 for Rs. 6,00,000. B Ltd. raises the invoice on 5.9.2013. A Ltd. makes the payment on 6.1.2014. Determine the point of taxation.
- a) 6.1.2014
 - b) 28.8.2013
 - c) 5.9.2013
 - d) 28.3.2014
85. Due date for payment of service tax in the case of individual assessee is _____ immediately following the quarter of the financial year except in case of last quarter.
- a) 5th of the month
 - b) 10th of the month
 - c) 15th of the month
 - d) 11th of the month
86. VAT is levied by:
- a) Central Government
 - b) State Government
 - c) Both Central or State Government
 - d) Any of the Central or State Government
87. If goods are purchased by Mumbai dealer from Delhi for Rs. 1,02,000 which includes CST of Rs. 2,000, Delhi dealer will get input tax credit of:
- a) Nil
 - b) Rs. 2,000

- c) Rs. 1,02,000
 - d) Rs. 4,000
88. Power to levy VAT is drawn from Constitution vide Entry No:
- a) 97 of the Union list
 - b) 92C of the Union list
 - c) 54 of the State list
 - d) 53 of the State list
89. VAT has replaced the:
- a) Central Sales tax
 - b) Local Sales tax
 - c) Goods & service tax
 - d) Excise duty
90. On the recommendation of which Committee, VAT was levied in India:
- a) Kelkar Committee
 - b) Chelliah Committee
 - c) Naresh Chandra Committee
 - d) Justice Verma Committee
91. In case of zero rated goods, input tax credit isand in case of exempted goods, input tax credit is.....
- a) Allowed, Allowed
 - b) Allowed, Not allowed
 - c) Not allowed, Not allowed
 - d) Not allowed, Allowed
92. Input credit on stock transfer to other states:
- a) will not be allowed
 - b) will be allowed only to the extent of tax paid in excess of 2%
 - c) will be allowed to the extent of full Input VAT on purchases
 - d) will be allowed only to the extent of tax paid in excess of 4%
93. Which of the following is not a method of computation of VAT:
- a) Addition method
 - b) Invoice method
 - c) Subtraction method
 - d) Gross product variant
94. Which out of the following cannot be a role of Company Secretary under VAT:
- a) Record keeping
 - b) Tax planning

- c) Negotiations with suppliers to reduce price
 - d) Carrying out departmental audit / assessment
95. In which of the following cases, VAT authorities cannot cancel the registration:
- a) The dealer has discontinued the business
 - b) The dealer has become insolvent
 - c) There is a change in the constitution of the business
 - d) Dealer has started selling one more product
96. Which of the following dealer is allowed to opt for composition scheme?
- a) Dealer selling goods within the State and not exceeding the specified limit of turnover
 - b) Dealer who makes inter-state purchases or sales
 - c) Dealer who wants to issue tax invoice
 - d) Dealer who exports goods outside India
97. X a dealer at Mumbai purchased goods from dealer Y of Mumbai for Rs. 13,50,000 including VAT @ 12.5%. X earns a profit @ 25% on the cost and sold the same goods to a retailer Z. Compute the amount of VAT payable by X.
- a) Rs. 37,500
 - b) Rs. 1,50,000
 - c) Rs. 1,87,500
 - d) Nil
98. VAT is a:
- a) First Stage tax
 - b) Last Stage tax
 - c) Multi stage tax
 - d) Single stage tax as per the option of the assessee
99. Which of the following is not an advantage of VAT?
- a) Easy to administer and transparent
 - b) Abolition of Statutory Forms
 - c) Deterrent against tax avoidance
 - d) No credit for tax paid on inter-state purchases
100. Which out of the following was first State to implement VAT in India:
- a) Delhi
 - b) Haryana
 - c) Uttar Pradesh
 - d) Maharashtra

ANSWERS

PART A	ANSWERS	PART B
1. d	35. d	71. a
2. b	36. d	72. b
3. d	37. c	73. a
4. c	38. d	74. c
5. b	39. a	75. a
6. b	40. d	76. c
7. b	41. b	77. b
8. b	42. b	78. c
9. a	43. d	
10. d	44. b	
11. a	45. d	79. b
12. a	46. a	80. b
13. c	47. a	81. b
14. c	48. c	82. c
15. c	49. d	83. c
16. a	50. b	84. a
17. d	51. c	85. a
18. d	52. a	86. b
19. b	53. d	87. a
20. c	54. b	88. c
21. a	55. b	89. b
22. a	56. b	90. a
23. d	57. a	91. b
24. b	58. c	92. b
25. c	59. b	93. d
26. a	60. b	94. d
27. a	61. c	95. d
28. b	62. a	96. a
29. b	63. b	97. a
30. c	64. a	98. c
31. a	65. b	99. d
32. c	66. d	
33. b	67. d	
34. c	68. a	
	69. d	100. b
	70. c	

SPECIMEN OMR ANSWER SHEET

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Examination Session : DD MM YY YY

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Use Blue/Black Ball Point Pen only

How to mark answers

CORRECT METHOD

WRONG METHOD

Question Booklet Code

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Subject Code

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Roll Number

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Answers

1	A	B	C	D	51	A	B	C	D
2	A	B	C	D	52	A	B	C	D
3	A	B	C	D	53	A	B	C	D
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5	A	B	C	D	55	A	B	C	D
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7	A	B	C	D	57	A	B	C	D
8	A	B	C	D	58	A	B	C	D
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10	A	B	C	D	60	A	B	C	D
11	A	B	C	D	61	A	B	C	D
12	A	B	C	D	62	A	B	C	D
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14	A	B	C	D	64	A	B	C	D
15	A	B	C	D	65	A	B	C	D
16	A	B	C	D	66	A	B	C	D
17	A	B	C	D	67	A	B	C	D
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46	A	B	C	D	96	A	B	C	D
47	A	B	C	D	97	A	B	C	D
48	A	B	C	D	98	A	B	C	D
49	A	B	C	D	99	A	B	C	D
50	A	B	C	D	100	A	B	C	D

Signature of Candidate with Pen

Name (As registered with ICSI)

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